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CHAPTER VIII (*Continued*)

MODES OF ENTIRE OWNERSHIP (*Cont.*)

§ 12. Contract of Life and Accident Insurance

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   - *b.*— What relation,
   - *c.*— When insurance may be paid to widow of insured,
   - *d.*— When policy is payable to legal representatives, who are meant,
   - *e.*— Policy payable to an estate,
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11. Beneficiary must have an interest in the life insured.
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1. Life insurance is usually effected in this country in the same manner as fire insurance, by insurance companies. An application is made by the insured, containing numerous questions that are asked by the insurers relating to the probability of life. These must be answered fully. In some cases questions also are to be answered by the physician of the person insured, others by his friends or relatives.

2. The premium for insuring for a year only, or less, is usually paid in money or by a note. For a period of more than a year the premium in most cases is payable annually. Sometimes a part of the premium is paid in money and a part in notes, which however, are rarely paid unless the amount is needed to pay losses.

3. The insurance belongs to the person who is designated as the beneficiary in the policy. But it is sometimes difficult to determine who is the beneficiary.

(*a*) For example, if the policy on the life of a mar-

ried man be payable to the children of the insured, who are included? Those by a former wife are, but not the children of his wife by a former husband. Children also includes an adopted child, but not a grandchild. Again, the by-laws of a company requiring the insured to designate as a beneficiary some one dependent on him, means one who is actually dependent on the insured for support. It therefore includes a wife, but not a creditor.

(*b*) By relations are included those by marriage as well as by blood, but not an illegitimate child.

(*c*) A policy payable to the executors, administrators or assigns of the insured, unless settlement shall be made by virtue of an article providing that the company may pay the sum insured to any relative by blood or connection by marriage of the insured, or any other person appearing to the company to be entitled to the same, is authority to pay the policy to the widow of the insured.

(*d*) The phrase "legal representatives" generally refers to the executors or administrators, rather than to the heirs or next of kin of the insured. In a life insurance policy these have a different meaning; they refer to the heirs of the insured, and are sufficiently broad to cover all persons who stand in his place and represent his interests.

(*e*) When a policy is payable to an estate it may be collected by the legal representative of the insured.

(*f*) By the weight of authority a policy payable to a wife and children conveys to the heirs of a child who dies before the insured the interest of the deceased child.

Likewise the proceeds of a policy — whereby a wife insures her interest in the life of her husband for her own benefit, if she survives him, otherwise for the benefit of his children, and dies during his lifetime leaving children surviving her, who also die during his life — go to the administrator of the children and not to the estate of the insured.

4. Generally, in insuring one's life when no power of disposition is reserved to the insured, the beneficiary acquires in the policy a vested right which cannot be impaired without his consent. In Wisconsin it has been declared that the insured may dispose of the policy by will to the exclusion of the beneficiary, when he has paid the premium and kept control of the policy.

In many states statutes exist which protect the interest of a married woman and her children, as against the claims of creditors of her husband in the proceeds of a life insurance policy on his life.

5. This rule does not apply to certificates issued by mutual benefit associations. By them beneficiaries do not acquire any vested rights. Says the Supreme Court of Indiana, the essential difference between a certificate of membership in a beneficial association and an ordinary life policy is that in the latter the rights of the beneficiary are fixed by the terms of the policy, while in the former they depend on the certificate and rights of the member under the constitution and by-laws of the society. In the one case the rights of the beneficiary are fixed and vested from the moment the policy takes effect. In the other they

are subject to such changes as the law of the associations authorises the society and the member to make.

6. The beneficiary may also dispose of his interest in the policy by pledge, mortgage, or gift.

7. The insured may reserve to himself the right to change the beneficiary at will. This is often done. In such a case the original beneficiary acquires no vested interest in the policy or its proceeds until the death of the insured.

8. As the parties may make any agreement they please about payment of the premium not contrary to statute or public policy, they may agree that the policy shall be forfeited for non-payment of the premium on the appointed day. But a forfeiture is not favoured "and a party who claims a forfeiture must show a fairly clear right to insist upon it."[1] This question most frequently arises when premium notes are given. Such a note executed at the same time as the policy is a part of it. Should the policy provide that if a premium note be not paid at maturity the policy would be void, its non-payment forfeits the policy. But such an agreement must be clearly expressed or it will not be enforced. If the insurer receives money on an over-due premium note from an agent without inquiry, the forfeiture is saved. The premiums must be paid on the days they fall due. When no hour is mentioned the insured has the entire day, even until midnight, to make payment. In some policies several days are allowed for the payment

[1] Ball v. Northwestern Mutual Accident Association, 55 Minn., 414.

of the premium; and an insurer is liable for a loss happening after the premium is due and unpaid, but before its period for payment has expired. Nevertheless, the utmost care is required on the part of the insured to pay his premium before or at maturity. By delivering a policy which on its face acknowledges the receipt of the first premium, an insurance company cannot afterward deny the payment. The legal effect of the policy dates from the time of paying the first premium, and not from the date of the policy itself.[1]

If the company accepts a note for the first annual premium and delivers the policy, this is a payment of the premium, even though the note is never paid. The burden of proof is on the party claiming under the policy to show that the first premium has in fact been paid, or the payment waived.

Payment to an agent is sufficient under a policy providing that if payment is not made into the home office within thirty days after the date of the policy it shall be void and of no effect. The time of mailing a check for the premium of an insurance policy is the time of payment, though it does not reach the company until past due.

Again, the placing of a policy of life insurance in the mail with postage prepaid, so that it would in course reach the insured before he was taken sick, is a delivery of the policy within the meaning of the

[1] A general agent of a life insurance company, it is presumed, has no authority to issue a policy for anything but money. Nor has he implied authority to waive payment of a premium in money and take something else in lieu of it.

clause declaring that it shall not be in force until the payment in cash of the first premium and the delivery of the policy to the applicant during his life and in good health.

9. Although a policy is not endowed with vitality until the premium is paid, payment may be waived or delayed by the company. The taking of a note would certainly be a waiver.

What authority has an agent to waive the terms of paying the premium? If the insured acts in good faith with the agent, relying on the statements made by him within the scope of his apparent authority, the principal will be bound by them. And if there be any limitation on his power, it is the insurer's duty to make this known to the applicant.[1] Therefore, if a general agent contracts to give the insured time for paying the premium and to accept payment in a specified manner, and forthwith delivers to him the policy of insurance, payment of the premium by the insured as agreed after an injury received by him sustains the contract notwithstanding the clause that "this policy shall not take effect unless the premium is paid prior to the offering of any accident under which the clause is made."[2]

The question has been raised more than once concerning the duty of the insured to read the policy. In one of the cases an application was made on December 12th, six days before the date of the policy. The premium was paid and the policy delivered on Decem-

[1] Kerlin v. National Accident Association, 8 Ind. App., 628.
[2] Bane v. Travelers' Ins. Co., 85 Ky., 677.

ber 26th, and the agent stated to the insured that the policy would be enforced for thirteen months from the time of paying the first premium. By the terms of the policy the next premium was payable on December 12th the following year with thirty days' grace, but the insured died on the 18th of January, having paid but one premium. The question was, what did the insured regard as the time within which his policy could run before expiration? The court held that he was not obliged to read the policy, that he had a right to suppose it ran a year from the time of its delivery, in which case it had not expired at the time of his death. The policy, therefore, by this construction, was not forfeited at the time of the death of the insured.

10. Many policies are called non-forfeitable, though so many conditions are attached to them that they doubtless mean much less than the insured imagines. In some states the statutes provide for the issuing of paid-up policies in place of them. Unless required by statute or agreement, the insurer is under no obligation to issue such a policy. When not knowing of the death of the assured, the policy was surrendered for a paid-up policy, the court reinstated the first policy.

11. Everyone for whom a policy is issued must have an interest in the life insured. The general rule is that any substantial pecuniary interest is sufficient, though not strictly legal or definite.

One who lives with a man as his wife, has an insurable interest though not lawfully married to him.

This applies to a sister who is dependent on a brother for support, and also to all cases in which there is a positive and real dependence. An existing debt also gives the creditor an insurable interest in the life of the debtor.

12. When the terms of the contract have been settled, the execution and delivery of the policy are not essential. The contract is generally regarded as complete on acceptance of the application and the auditing of the premium. And any act on the insurer's part which leads the applicant to take out no other insurance, supposing that his application has been accepted, will bind the insurer. On the other hand, the insurer is not bound until the application is accepted.[1]

13. A life policy may be assigned or transferred. Many policies are made for the purpose of transferring them; in other words, for the purpose of enabling the insured to give this additional security to creditors. It is an important question, what constitutes an assignment. A delivery and deposit of a policy for the purpose of transfer will operate in that manner without a formal written assignment. So will any transaction that gives to a creditor of the insured a right to receive payment from the insurance fund. A delivery of the policy is necessary; consequently if it remains in the possession of the insured, though an assignment is indorsed thereon of which the insurers have notice, the transfer is not completed. But a transfer may be effected by a separate instrument, which is duly executed and delivered, without actually

[1] Allen v. Mass. Mutual Accident Association, 167 Mass., 18.

delivering the policy itself. The mode of assigning or transferring policies is generally regulated by the by-laws of the insuring company or by the terms of the policy.

Under the New York statute, which authorises a married woman to insure her husband's life for her sole use, a policy was held to be not assignable. Said the court: "policies of life insurance in favour of the wife on the life of the husband, we have persistently held to be non-assignable. We have determined that their peculiar character and purpose necessarily took from them their most important characteristic and purpose in general." By a subsequent law such a policy may be assigned with the written consent of the husband.

14. Generally the company requires notice of an assignment; and if this be not given the policy is thereby invalidated. The notice is sometimes held to be directory, and not to affect the legality of the transfer as between the insured and the assignee. Surely no one but the insurer can question the validity of an assignment without notice.

As the intention of the parties must govern, the transfer of the policy by delivery with a verbal direction concerning the distribution of the proceeds is a good assignment, even though the policy requires this to be done in writing.

15. The assignee of a policy held as collateral security for a debt of the insured cannot sell or surrender it to the company for its cash value without giving the insured a reasonable time to redeem, but the

assignee has a right under ordinary circumstances to assign the policy to another party. Thus, one who holds a policy as collateral security for the payment of a note may assign it to the indorsee of the note and confer on the assignee a right to hold the policy as collateral for the note itself.

16. The principles concerning warranty, representation, and concealment are the same as those already considered relating to fire and marine insurance. In life policies, however, the questions cover more ground, and the answers contain more difficulties, especially in discriminating between what the insured knows and what he believes. If he says simply "yes," or "no," this in most cases is a warranty and avoids a policy when there is a mistake in the reply; but if he answers, "to the best of my knowledge and belief," he warrants only the fact of his belief and nothing more.

Thus, the risk increases with age, but an unintentional mistake of a short period is not material and will not avoid the policy. But an applicant who said he was thirty when in truth, he was thirty-five went too far. On the other hand, an applicant who states his age "to the best of his knowledge and belief," and stipulates that any undue or fraudulent statement shall forfeit his right to recovery, does not thereby forfeit his policy, even though he be three or four years older than his statement unless this was known to be untrue.

17. In every case good faith should be observed. Thus, the policy of a person who, at the time it began

to run, was wholly unconscious of his insanity, was not invalid by the concealment, although two doctors who attended him understood his real condition.

18. A correct answer must be given to a question which requires the applicant to state his occupation. The answer must be substantially correct. But an applicant who states that he is a soda-water maker, when, in fact he is simply a soda-water seller, is not guilty of a breach of warranty.

Again, an applicant who declared that he was a dry-goods clerk, but failed to state that he occasionally was employed as a bevel smoother of plate glass was not guilty of bad faith.

19. Questions are often asked applicants for insurance concerning their habits, and answers are given that may not be altogether correct. Suppose a question should relate to the use of liquor, an answer declaring one to be of temperate habits does not mean that he is a total abstainer. The Supreme Court of the United States has declared that a man may be of temperate habits, although he once had delirium tremens.

20. In construing a statement concerning the intemperate use of liquors, a court on one occasion said: "An occasional excess in the use of intoxicating liquor does not of itself constitute a habit and make a man intemperate within the meaning of this policy, but if the habit has been formed, and is indulged in to drinking to excess and becoming intoxicated daily and continuously or periodically, with sober intervals of greater or less degree, the person addicted to such

habit cannot be said to be of temperate habits within the meaning of this policy."

Again, an applicant who stated that he never used narcotics was still within the rule by showing that he never used them in such a way as to create a custom or habit.

21. What is the meaning of good health in a life insurance policy? An eminent authority has said an applicant is not required to know and state with absolute certainty his physical condition or his predisposition to different diseases, but it is sufficient that he in good faith discloses fully all that he knows about his past and present health. Sound health means freedom from disease or ailment which affect the general soundness or healthfulness of the system seriously, and the word serious is not generally used to describe a dangerous condition, but rather a grave, important or weighty trouble. A temporary indisposition, such as an ordinary cold, is not an illness within the meaning of that word as used in an application for a policy.

In a well-considered case the Supreme Court of New York said that the word health was a relative term. When one is described as being in good health this does not necessarily or ordinarily mean that he is absolutely free from all and every ill. If the phrase were so interpreted as to require entire exemption from physical ills the number to whom it could be strictly applied would be very inconsiderable.

22. The most important question on applications for life insurance is, whether the applicant is exempt

from any dangerous disease, one which frequently terminates fatally. Some slight physical disturbance, of which in all human probability he will soon be relieved, although it might possibly lead to a fatal disease, is rarely deemed an objection.

23. On one occasion an applicant said: "I have never been physically injured." The court said the reasonable interpretation of the clause was that at that time he was free from serious physical injury and that any injury that he may have suffered from in the course of his previous life had disappeared and left no traces behind that would render him an unfit subject for accident insurance, that he was as to such accidents and their results free from bodily ailments.

24. A false statement concerning a consultation with a doctor invalidates a policy. This rule has been declared, but must have a reasonable construction. The false statement must relate to some substantial injury or ailment, not to a slight or temporary indisposition. Thus, consulting a physician for a cold is not a breach of the condition that the insured has not been under the care of a physician.

25. An insurance company should receive correct answers concerning the family history. It is important to know about disease among its members. Material variation from the truth will render a policy void in this regard. A false answer in response to a question concerning any other insurance will generally invalidate a policy.

26. Once insurance companies had great difficulty in relieving themselves from loss by suicide, though

expressly stating they would not respond for a loss thus caused. The courts drew a distinction between suicide that was voluntary and wrongful, from which the insurer was relieved, and suicide caused by insanity or other disease for which the insurer was responsible. So long as this distinction existed it was difficult for companies to escape payment whenever the insured took his own life. Finally, they adopted a provision declaring they would not pay if the insurer died by his own hand, whether sane or insane. This phrase overcomes all difficulties.

The presumption is always against the fact of suicide, and therefore, while there is a reasonable doubt whether death was due to suicide or accident, the presumption is in favour of the latter. The presumption against suicide is sometimes said to exist only when the insured was insane.

27. It was once a question whether death by order of law discharged an insurer when the policy was silent on the matter. Perhaps the weight of authority is in the affirmative, but the question does not now have much importance.

28. Sometimes the time of death is very important. If a policy be for a definite period the death of the insured must be shown before the end of the period. When nothing has been heard from a person for seven years death is presumed in some states by the common law; in others, by statute. Some companies, however, require absolute proof of the fact of death before paying a policy.

29. The only troublesome question that arises in

reference to other insurance is, whether it includes certificates in a mutual benefit association. On this point the courts divide. In some states such associations are included among insurance companies; in others, excluded.

30. Within a comparatively recent period another kind of insurance has become very general, taking the name of accident or accidental. This includes any actual or unexpected result attending an act. The accident must be the proximate and sole cause of the injury to form the foundation of a recovery.

31. A policy insuring against death or accident caused by external, violent or accidental means, covers death by stumbling and falling against a locomotive engine; a fall due to a temporary and unexpected physical disorder; an accidental strain causing death; a blow struck by another person; to excitement and strain caused by attempting to hold and control a frightened and run-away team; by accidental drowning; by drowning while attempting to rescue the crew of a wrecked ship; a rupture caused by jumping from a train; choking to death while attempting to swallow a piece of beefsteak; injury caused by the sting of an insect; hanging at the hands of a mob; by inhaling gas while working in a well; blood-poisoning; lock-jaw produced by a gunshot accidentally inflicted upon the insured himself; death or injuries caused or resulting from carrying heavy baggage, contact with a poisonous substance, rupture of blood vessel, stooping, death or injuries caused by or resulting from accidental taking of poison, blood-poisoning,

discharge of loaded gun, eating dangerous food, falls, fright, lifting, rupture of tympanum of ear, shooting, strain, suicide while insane, unintentional inhalation of gas. But a rupture caused by jumping from a train, where the insured acted for his own convenience, and not from necessity, was held not to be within the conditions of an accident policy insuring against injury caused by violent or external means. So, sunstroke contracted in the course of the ordinary duties of an architect is a disease, and not an accident caused by external, violent or accidental means.[1]

An insurer may make exceptions. Intentional injuries inflicted on the insured are usually considered "accidental" and come within the proviso that the insurance shall extend to injuries sustained through "external, violent and accidental means." If one dies from disease or bodily infirmity of course this is within the exceptions and the same rule is applied if death is due both to bodily disease and accidents. If death from "inhaling gas" forms an exception, this means by voluntary and intelligent action, and not the unconscious inhalation of gas that is filling a room. Nor is the insurer relieved from liability for death thus caused, by a clause in the policy providing that it shall not cover death resulting from anything accidentally or otherwise taken, administered, absorbed, or inhaled.[2]

32. Such policies are often issued to travellers. The policy covers an accident occurring while the insured

[1] See Bacon on Life Ins., § § 483–490, p. 964.

[2] Menneiley v. Employers Liability Assurance Corporation, 148 N. Y., 596

is alighting from a train, either at the intermediate station or at his destination. Usually it limits the risk to a conveyance by a common carrier and not to every kind of conveyance. A party who is insured against accidents while travelling by public or private conveyance can recover for an injury sustained while going on foot from a steamboat landing to the railroad station for the purpose of continuing his journey. On the other hand, a person who has left the landing place of a steamer and is injured while walking home cannot recover, because he is not then travelling by a public or private conveyance.

The risks of travel do not extend to an injury sustained in falling from the hay-loft of a livery barn. And if the policy provides that if the injuries "are sustained while riding as a passenger in a passenger conveyance using steam, cable or electricity as the motive power, the amount to be paid shall be double the sum above specified," these words do not apply to one riding on the platform of a railway car.[1]

Again, if the policy require a traveller to comply with all the rules of the carrier while pursuing his journey, he is not thereby bound to inform himself of the carrier's rules, yet he cannot recover, if injured through a known violation of them.[2]

Policies usually contain restrictions or limitations concerning residence or travel; the person insured cannot go beyond specified limits or places without

[1] Ætna Life Ins. Co. v. Vandecar, 96 Fed., 282.
[2] Bon v. Railway Passenger Assurance Co., 56 Iowa, 664.

permission. Sometimes the permission is not granted without paying an additional premium.

A policy that prohibits living within a specified degree of latitude, but gives permission to pass as a passenger by the usual mode of conveyance to or from a place in the prohibited limits, is not invalidated by the fact that the insured was compelled by sickness to remain there until he died.[1]

Again, the provision concerning residence is waived by the company's retention of the premium after notice of a breach of the conditions to the agent authorised to receive the premium.

33. Sometimes the policy relieves the company from liability caused by the taking of poisonous substances or the inhaling of gas, introductory to a surgical operation or medical treatment. In such a policy an insurance company is held liable for a death caused by illuminating gas accidentally inhaled while asleep at a hotel. So, too, death caused by the poisonous sting of an insect is not within the exemptions, even though the exemption by poison be expressed in a broad manner — poison in any form or by contact with poisonous substances.

A policy containing this stipulation: "I agree that this instrument shall not be held to extend to poison in any way taken, absorbed or inhaled," relates to the mode or manner of taking poison, and not to the motive of the insured in taking it. The words do not therefore in any way cut off a recovery from the company.

34. The ordinary accident policy insures against

[1] Evans v. U. S. Life Insurance Co., 64 N. Y., 304.

accidents arising from occupation or employment. The risks greatly differ; some are so hazardous that companies are unwilling to insure employees against accident. Sometimes the contract provides that if the insured is injured in any occupation more hazardous than that stated by the insurer, the insurance shall only be what the premium would purchase at the rate fixed by the tables for the increased hazard. In such a case the jury must determine whether there has been an increase in the risk or not. Thus, an insured gave his occupation as that of a blacksmith employed by a railroad company; he also acted as a switchman and car coupler. The latter occupation being classed as more hazardous than the former he was allowed to recover the amount the premium paid would have secured in the more hazardous occupation.

The term occupation, refers to the vocation, profession, trade, or calling of the insured. The contract covers all the dangers to his occupation, and he is not precluded from things that are incident to the daily life of men who are occupied, nor from acts of exercise, diversion, or recreation. To enable the insurer to avoid the policy because the death or injury of the insured was incurred in some other occupation than that covered by the policy, it must contain an express provision of this nature. Thus a person insured was a "switchman," the insurer tried to show that when killed he was acting as brakesman. The court declared that his occupation "as switchman did not amount to a covenant that he would do no

act not connected with such occupation, or that he would not engage in any different occupation." [1]

35. A mere occasional act, not within the scope of the occupation covered by the policy, is not regarded as engaging in another occupation. Thus, a person who is insured as a grocer may hunt for pleasure, and a person insured as a mining expert does not become an engineer or fireman by riding occasionally on an engine. A banker does not change his employment to that of a sawyer by briefly operating a saw for the purpose of getting some boards wanted for immediate use. But to operate a buzzsaw for one's own amusement is not within the permissible pleasures of a retired gentleman.[2]

36. A provision declaring that there will be no liability for injuries causing no external and visible signs does not apply to injuries resulting in death. Under such a provision the insured is permitted to recover for injuries caused by a strain which produced no external result until some time after the accident. A nosebleed is an external sign of injury.

Whether there are such signs is a question of fact. A discoloration of the shoulder is an external sign, also pallour and grayish look about the face, the injury need not be visible to the eye, if it can be ascertained by using the sense of feeling. Again, if the signs of the injury do not appear until some time after the accident, the insured can recover.

37. Accident policies usually exempt the insurer

[1] Provident Life Ins. Co. v. Fennell, 49 Ill., 181.
[2] Bacon, § 491, p. 990.

from liability from death or injury caused by voluntary exposure to unnecessary danger or hazard, or perilous adventure. Two classes of accidents are thus excluded from the risks insured: first, accidents that arise from exposure by the insured to a risk or injury, which is obvious at the time of exposing himself; secondly, accidents that arise from the exposure by the insured to a risk or injury which would be obvious to him at the time if he were paying reasonable attention to what he was doing.

The insured is entitled to recover, even though the accident was caused by his own negligence, unless an exception is made in the policy. This usually provides that the company shall not be liable unless the insured exercises due care for his personal protection. By virtue of this provision he is bound to exercise that degree of care which an ordinary prudent man would use under the same circumstances.

38. The phrase "voluntary exposure to unnecessary danger" has been the subject of much litigation. In one of the best works treating on this subject the author says that it means "intentional exposure to a danger; as where a person acts so recklessly and carelessly as to show an utter disregard of known danger, or does an act in the face of a risk and danger so obvious that a prudent man, exercising reasonable foresight, would not have done it. It means dangers recognised, but consciously and intentionally assumed. A policy containing such a provision does not relieve the company from liability for injury which resulted from a voluntary exposure to a danger which was

contemplated by the contract. A party who goes out in a boat on a dark night to fish, without a knowledge of the existence of snags which are dangerous to his boat, does not expose himself to unnecessary danger within the meaning of such provision. Nor does a person voluntarily expose himself to danger by riding in a bicycle race and overexerting himself; nor by cleaning a gun, without the knowledge that it was defective and loaded; nor by visiting a house of ill-fame and getting shot immediately after leaving the place; nor, generally, by doing what a man of ordinary prudence would do under the same circumstances; as by climbing a bank with a loaded gun in his hand while hunting. But there can be no recovery under such a policy for an accident occasioned by jumping from a moving train after it has passed the station; or by attempting to cross through a freight train standing across the highway; or by attempting to lower himself from a window to avoid police officers who were at the door. A person who, with packages in his hands, attempts to cross over a trestle which he knows is dangerous, while there are other ways of travel open to him, voluntarily exposes himself to unnecessary danger. But it cannot be said, as a matter of law, that a person voluntarily exposes himself to unnecessary danger by crossing a railroad trestle bridge where there is a plankwalk and a fence railing on one side. Whether standing on the platform of a moving train which is going at a rapid speed is a voluntary exposure to a known danger, is a question for the jury. Whether under all the circum-

stances, going on a railroad track or bridge is a voluntary exposure to unnecessary danger, is a question of fact which should be submitted to the jury."[1]

39. The phrase "bodily infirmity or disease" in an accident policy has been construed on many occasions. In one of the cases the court remarked, concerning the meaning of this phrase: "When speaking of an 'infirmity' we generally mean the state or quality of being infirm, physically or otherwise — debility or weakness; and by the use of the word 'disease' we desire to convey the impression of a morbid condition, resulting from some functional disturbance or failure of physical function which tends to undermine the constitution. We do not, as a general rule, apply either term to a slight and temporary disorder, or to the imperfect working of some function, which is over in a short period of time, and which, when recovered from, leaves the body in its normal condition. In using either of the words we do not, as a rule, refer to a slight and mere temporary disturbance or enfeeblement. If this is true of our ordinary speaking and writing, it is certainly clear that the words should be given no broader meaning when we find them used by an insurance company in a clause of its policy which it relies upon to defeat a recovery thereon."[2]

40. Accident policies insure against accidents intentionally inflicted on the insured by a third person; in many policies this risk is expressly excepted.

[1] See 2 Bacon, § 492, p. 993, and Kerr on Insurance, § 150, p. 396.
[2] Meyer v. Fidelity & Casualty Co., 96 Iowa, 378.

Under this clause a court declared that there could be no recovery from injuries caused by fighting, although the insured was not the aggressor. There is no liability when one is intentionally shot and killed by another person. This has happened on more than one occasion to a person who has been waylaid and shot by a robber.

41. Another provision bars a recovery when death occurs in consequence of engaging in an "unlawful act." Is this phrase broad enough to cover every unlawful act, whether criminal or civil? The better opinion seems to be that it covers all. Thus, the Supreme Court of Indiana in a recent case has remarked: "A known violation of a positive law, whether the law is a civil or criminal one, avoids the policy if the natural and reasonable consequence of the act does not increase the risk."

Cases have happened of injury to the insured while hunting on Sunday, in violation of the law. In many states the courts have denied a recovery in such cases. In one of them an accident happened while the insured was returning from a hunting expedition. As the statute made both travelling and hunting on Sunday a crime, the insured failed to recover.

42. A contract providing there shall be no recovery for injuries received while the insured is intoxicated relieves the insurer, even though the intoxication was not the immediate cause of the injury.

43. Besides this form of insurance may be mentioned that of employers. The constant risks to which

[1] 2 Bacon, § 339, p. 689.

employers are liable from their employees has given rise to this form of insurance. A contract exempting the master from liability from the results of his negligence is void as against public policy; but a contract with a third person whereby he agrees to indemnify the master is valid.

44. Not infrequently an employee gives an order on his employer for the premium which is to be paid out of his wages. Such an order or assignment covers only the period designated usually, one, two or more months. If therefore it is not paid out of those months, it cannot be paid from the wages earned by him during any others. On the other hand through his failure to pay the instalments on his policy as agreed, the insurer's liability to him is ended. On one of these occasions the court held that the company was not obliged, in order to escape liability, to return to the insured the order and notify him that the contract was at an end, since by its express terms the insurance was to cease at the end of any period if the premium for the succeeding period was not paid.

False representations, which are material relating to his physical or mental condition, or occupation will avoid the policy. The insurer's knowledge of a false representation is a waiver of its effect, and actual knowledge by an agent will be deemed the knowledge of the insurer.

45. The employer is insured against loss resulting from his liability for injuries. The law is liberally construed for the purpose of securing to the insured the protection for which he has paid. Thus, a policy

insured an ice company against claims for damages on the part of its employees in all operations connected with the business of ice dealers. This language was declared to cover or include only employees in the operating department. A person, therefore, who was injured while constructing an ice-house was not included in the policy.

A policy was issued restricting injuries to employees engaged in the business of iron and steel works. An employee was injured while engaged in the building department by the fall of a girder. "The general language of the contract," said the court, "is not restricted by anything in the conditions indorsed on the policy or any way made part of it. If the intention was to restrict such language to operations in any particular department, or to any particular branch of the business or to any particular instrumentality used in said business, it was easy to have said so in unmistakable language."

46. A policy indemnifying for injuries to non-employees resulting from accident caused by horse cars, railways, machinery or appliances used in the business of the insured and described in the application, does not include injuries caused by the use of omnibuses, sleighs, etc., as the risk is different. Whether the risk is increased or diminished depends on the circumstances of the particular case, but the risk in the use of sleighs clearly differs from that in the use of cars.

In recovering for the loss of a member of the body when the policy provides for the payment of an in-

demnity for the "loss of one entire hand or foot," or the "loss of two entire hands or feet," in order to recover there need not be an actual physical severance of the member from the body. Any loss rendering the member useless fulfils the agreement. But the loss must be entire if the contract specifies an "entire hand," or an "entire foot." If a policy provides for the payment of a sum for the "complete and irrevocable loss of sight in both eyes," and the insured is a one-eyed man, the insurer is liable if the insured loses the other eye.

47. One other form of insurance may be briefly mentioned — fidelity insurance. This is of still more recent origin. Employers are insured against loss caused by the fraud or dishonesty of their employees. "Guaranty insurance," says Justice Wilkin, "is, in its practical sense, a guaranty or insurance against losses in case the person so guaranteed makes a designated default or be guilty of specified conduct. It is usually against misconduct or dishonesty of an employee or officer, though sometimes against a breach of contract. This branch of insurance is so much more modern in origin and development than fire, marine, life and accident insurance that there are few decisions upon the subject; but the business is gradually increasing and is doubtless destined to take an important place in the commercial world. It may be confidently stated that, notwithstanding the comparative absence of specific decisions, the general principles applicable to other classes of insurance are applicable here as well. Thus, the general doctrine

of warranty, representation and concealment, as applied to fire, life and marine insurance, is applicable also to the subject of guaranty insurance." [1]

Fidelity policies usually provide that the insured shall promptly notify the company of any fraud or dishonesty on the part of the employee. A failure to do this usually prevents recovery.

[1] People v. Rose, 174 Ill., 310.

CHAPTER IX

MODES OF LIMITED OWNERSHIP

§ 1. Mortgage of Personal Property

1. Once this could not be done.
2. A statutory right.
3. Is not a sale with right to repurchase.
4. A conditional conveyance.
5. How deed must be executed.
6. Property should be described.
7. Future acquired property.
8. Mortgagor may secure contingent indebtedness.
9. Mortgagor need not have absolute title.
10. What statutes require.
11. Recording.
12. What must be done when there is no registration.
13. Mortgagee's right to take possession.
14. Sale by order of court.
15. Mortgagor cannot prejudice mortgagee by making another mortgage.
16. Assignment of mortgage.
17. Maturity of notes of different dates secured by same mortgage.
18. Consequences of mortgagor's neglect to pay instalments.

19. Equity favorably regards mortgagor's retention of his property.
20. Foreclosure.
21. Payment.
22. Mortgage of ship.

1. FORMERLY a mortgagor could not make a valid mortgage of personal property and retain possession. For, as the common law regarded the possessor of property as the owner, his sale of it to anyone in good faith for a valuable consideration, followed by delivery, conveyed a good title to the buyer. While this was the law, the mortgagee had no real security for his loan, consequently mortgages of this character were extremely rare.

2. By statute the mortgaging of personal property has been established probably in every state; and in many respects the mode of making them and the rights of the parties thereto conform to the law of mortgaging real property. The mortgagor is permitted to retain possession until default of payment; indeed, he generally retains possession of his property the same as before.

3. Such a mortgage should be distinguished from a sale with a contract for repurchase. In determining whether it is one thing or the other the intention of the parties is the guide. Often an absolute transfer on its face has been shown to be only a pledge or mortgage.

4. A mortgage of personal property is a conveyance with a condition. It is made to secure a note, either

payable on time or on demand. A mortgage may be made for some other purpose, though in most cases it is of this character.

5. In a mortgage of real estate, as we have shown, it is essential to have the writing or deed executed with all the formalities prescribed by law. A chattel mortgage need not be so executed. Indeed, it may be valid even if there be no instrument or writing whatever. This is especially true unless some statute exists requiring more formality in executing the conveyance. Generally statutory forms are prescribed and deeds are made with the same care and recorded in the same manner as mortgages of real estate.

6. The property should be clearly and specifically described so that it can be separated from any other, to be within the protection of the law. A defective description may be cured by a subsequent conveyance. Sometimes a schedule of property is annexed to the deed. This does not enlarge the scope of the mortgage, but is simply what it purports to be, nothing more.

7. With respect to future acquired property the law is still in darkness. In mortgaging property the natural increase therefrom is included or covered by the mortgage; in no other case is future acquired property included unless the deed itself or custom clearly provides for the inclusion. In some cases machinery or stock that is to be added subsequently is covered by the mortgage. Chattels that are to be acquired also pass in the same manner when this is the clear agreement or intention of the parties.

This question often arises in mortgaging goods,

which are undergoing constant change by reason of daily sales and additions. A mortgage that provides for such a change of security is perfectly valid, unless the statute otherwise prescribes.

8. A mortgagor may secure a contingent indebtedness. Indeed, he may secure any payment whatever. Parol evidence may be admitted to show the purposes for which a mortgage was executed, and to identify the note intended to be secured thereby.

A mortgage to secure further advances is valid and any debt that is wholly future may be secured and not merely a present or pre-existing debt. Nor need the amount of intended advance be stated in the mortgage when the purpose is described with reasonable certainty.

To give effect to such a mortgage as against a bona fide purchaser or a judgment creditor, or any other claimant, the mortgagee must show that he has made the advance or incurred the liability mentioned, or that the debt or liability is still outstanding.

Advances, made after the mortgagee has actual notice that others have acquired bona fide rights for value in the property, will be postponed to them, unless it is clearly to the mortgagee's interest that he should make additional advances to protect his interest.

9. It is not necessary that the mortgagor should have an absolute title to property, which is the subject matter of the mortgage. For example, the owner of a chattel not in possession, which is already pledged, may make a valid mortgage of the thing subject to

a pre-existing pledge or lien. In such a case notice to the pledgee or lien claimant would be proper. There may be a prior and junior mortgage of the same thing.

Of course, a mortgage should be a bona fide transaction like any other contract, and be made by competent parties, and based on good morals and public policy.

10. The statutes require the registration of mortgages of personal property. By fulfilling the requirement a mortgagee usually acquires as perfect title to or interest in the thing mortgaged as that of the mortgagee of real estate. As contests between mortgagees and attaching creditors of a mortgagor are often sharp and bitter, it behooves a person who is taking a mortgage on personal security to have the deed drawn in a careful manner and registered with all the formalities accompanying a mortgage on real estate.

11. The recording or filing of a mortgage is in effect a transfer of the property mortgaged to the mortgagee. If this were not done the attaching creditors of the mortgagor would be justified in taking it unless they had actual notice of the transaction between the two parties. Of course, a mortgage of personal property may be made without recording it or without any writing, which is valid between the intermediate parties, but the object of the writing and registration is to make the transfer effective beyond the parties themselves. By recording an effective notice is given to everybody.

12. When there is no registration, in order to make

the mortgagee's title complete, there must be a delivery or change of possession of the property. What this must be depends on circumstances. A mortgagee has been deemed in actual possession from an attaching creditor's point of view by placing a keeper over the mortgaged goods, though concealing somewhat his presence because of the mortgagee's kindly regard for the mortgagor's family. Mortgaged property may in general be delivered and kept by a bona fide agent of the mortgagee. No formal ceremony is essential, but when mere words of delivery are used and the goods remain on the mortgagor's premises, either under his own personal charge or that of his former agent, the change of possession is not sufficient to satisfy the law. Generally, personal property that is mortgaged of which no record is made ought to be taken into the mortgagee's possession to make the title secure against other parties who may make claim thereto as the property of the mortgagor. It need hardly be added that the mortgagee's conduct ought to be honest and open.

13. A mortgage usually provides that if the debt is not paid at maturity the mortgagee may take possession and dispose of the property. The mortgage therefore is a somewhat arbitrary conveyance, as all authority and action relating to the security are confided to the mortgagee.

A law giving to the mortgagee the right to take the property, either absolutely in satisfaction of his debt, or with the right to sell within a fixed time, or at his discretion, and to apply the avails in satisfaction of

the debt, and the surplus, if there be any, to the mortgagor, must be faithfully executed. Should the mortgagee resort to any trick for selling the property at less than its value, in short, to any way contrary to law, the transaction may be reviewed by a proper tribunal and the wrong perpetrated on the mortgagor may be corrected.

14. The authority to take and sell the property is not always confided wholly in the mortgagee. And if the mortgage be for a large amount it is better for all who are interested therein to apply to the court for an open judicial sale, thereby relieving the mortgagee of all possibility of incurring the displeasure of the mortgagor, or of attaching creditors, or of other parties who may have an interest in the disposition of the mortgaged property. This course is often pursued in disposing of a chattel mortgage and closing the relationship between the two parties.

15. A mortgagor has no right to pledge or mortgage the property of another person or create any other lien thereon prejudicial to the rights of the mortgagee. How far he can sell the mortgaged property is determined by the statute of the state in which it is made, or by the deed itself. If the property is not of the kind usually sold during the life of the mortgage, or not sold in accordance with the custom or usages of trade, the mortgagor of course commits a fraud in taking advantage of his situation to part with the security belonging to the mortgagee. When the property is left in the mortgagor's possession his opportunity to wrong the mortgagee, if so inclined, is apparent. Suppose a

mortgagor should be a dealer in costly jewelry or other goods left in his possession, and all the requirements of the law are fulfilled with respect to recording the mortgage, nevertheless, it would be very easy for the mortgagor, were he so inclined, to rob the mortgagee of a considerable part of his security before his discovery of the mortgagor's doings.

16. Such mortgages are frequently assigned by the mortgagee like a mortgage of real estate. This is usually effected by writing an assignment on the back and having this recorded in the same manner as the original deed. When this is properly done the assignee acquires quite as good a title to the debt and property as was possessed by the mortgagee.

17. On the maturity of several notes at different dates, secured by the same mortgage, the mortgagee may at his option take possession on the first default, if not in possession already, or he may await the maturity of the last note.

18. It is the mortgagor's own loss, should he neglect to pay the instalments as they fall due, and thus save a forfeiture of his property. All legal claim on the mortgagor's part is gone after forfeiture, and he cannot compel the mortgagee to receive payment and restore the property. Nor is the mortgagee bound, after taking possession because of the mortgagor's failure to comply with the mortgage, to make a sale unless the deed requires this to be done.

19. Equity looks with a favourable eye on the retention of possession by a mortgagor, and will do whatever is possible in the way of securing fair treat-

ment from a creditor. Therefore, anything like fraud or harsh dealing on the part of a mortgagee, the taking of the property without proper notice or by an unfair sale, will be corrected by a court of equity on the proper presentation of all the facts.

20. In foreclosing a mortgage, which is often done, the court proceeds in the same manner as with a mortgage of real estate, first fixing a time for the mortgagor to pay, and after his failure to do so, transferring all his right and interest in the property. When the property is sold, the surplus, should there be any, belongs to the mortgagor; should there still be a deficit he is liable therefor.

21. The payment of a mortgage debt to the mortgagee by some third party, who is under no obligation to pay, does not necessarily operate as a satisfaction. The intention of the third party in making the payment must be regarded. If it is his intention to preserve the debt the law will keep it alive. Whenever a mortgage debt is extinguished so is the mortgage security.

22. A ship may be mortgaged like other personal property and the national statute provides how this shall be done. In general it may be said that the mortgage must be registered like a mortgage of real estate and the methods of dealing with it are quite the same.

§ 2. Pledge of Personal Property

1. What may be pledged.
2. Natural increase follows the thing pledged.

3. Property should be delivered to pledgee.
4. When pledgor may retain it.
5. What care pledgor must take of it.
6. What use can pledgor make of it.
7. Pledgee may transfer his debt and security.
8. Pledgor's remaining rights.
9. Pledgor's bankruptcy does not affect pledgee.
10. Pledgor's consent is necessary to give pledgee good title.
11. Negotiable paper is an exception.
12. Collaterals:
    a.— Presumptively they belong to pledgor,
    b.— Is pledgor or pledgee liable for an assessment?
    c.— Does a pledge cover a renewal?
13. Rights of pledgee holding various collaterals.
14. Pledge of collateral security received from a third person.
15. Pledgor must pay or permit pledgee to sell.
16. Notice of sale.
17. Mode of sale.
18. Purchase by pledgee.
19. Balance due pledgor or pledgee.
20. Effect of subsequent agreement to accept collaterals in settlement.
21. Pledgor must pay expense of sale.
22. Pledgee may sue pledgor instead of selling property.
23. By paying debt pledge is extinguished.
24. Pledgor on payment of his debt may have his property.
25. Pledgee cannot divert property.

26. Effect of relinquishment by pledgee of collaterals on other creditors.
27. Pledges to pawnbrokers.

1. Personal property is often pledged for debts, and in setting forth the law relating to pledges, the first question is, what can be pledged? Almost every kind of personal property and rights of personal property, all kinds of merchandise and securities, shares of stock, bank-notes, mortgages, leases, patent rights, and the like. The principal exception is property not existing at the time of the pledge, though there may be a mortgage of future acquired property. It is contrary to the law to pledge some things — pensions, bounties to soldiers and sailors. The law guards the business of pawnbrokers, because they sometimes take property that ought not to be received; or take advantage of the situation of the pledgor to make unreasonable demands. Partnership property cannot be pledged for an individual purpose. A transfer of bonds belonging to a company by the president as collateral security for a pre-existing debt of his own is void, even if he were authorised to sell them.

2. In pledging a thing for a particular purpose the natural increase also follows and enures to the benefit of the pledgee. Thus, the young ones of a flock of sheep, which are the subject of a pledge, become a part of the flock. In like manner the dividends of interest on stock or other securities go to the pledgee, unless the agreement says otherwise.

3. Pledged property should be delivered to the pledgee. The reason is, the property that remains in the pledgor's possession is regarded by the law as still his, and may be taken by his creditors to satisfy other debts.

4. Many of the states provide by statute for the retention by the pledgor of his property, while granting adequate security to the pledgee. But it is contrary to the policy of the law to permit or sanction a secret transfer. This rests on a sound reason, that creditors may not be surprised or defrauded by the discovery that the possessor of wealth is not the real owner.

With respect to stocks, the law in some states, though not in all, provides that the delivery of a certificate to the pledgee, signed in blank, shall be a sufficient delivery of the property. The law requires nothing more than this transfer of the certificate to protect the pledgee's or purchaser's interest from the seller's creditors.

This transfer, if sufficient to protect the pledgee, is so solely by virtue of the statute. Consequently, all other property, not within the statutory ken, must be actually delivered to the pledgee in order to make his security complete.

5. What care must a pledgee exercise over the property? The law has endeavoured to measure the care by the compensation received for the service. In keeping stocks a receiver or keeper who receives no compensation but simply does this for another's accommodation, need exercise a less degree of care than a person who is especially engaged in the busi-

ness, and who receives a compensation therefor. For example, once it was a common practice of bank depositors to ask their cashier to keep their bonds or other securities and valuables for them in the bank's safe during their sojourn by the sea, or abroad. As this was a purely gratuitous service, losses by fire, robbery, or other cause, unless the bank was grossly neglectful, could not be visited on the institution. On the other hand, a bank with a safe-deposit department, or an institution engaged solely in the business of keeping securities for a compensation, must exercise the highest degree of care; is essentially an insurer; and is responsible for a loss by fire or robbery, unless it can prove the exercise of the highest degree of care.

A bank receives a direct pecuniary benefit from stocks or other securities pledged for a loan, and is obliged to exercise more than ordinary care in keeping them. Should a loss therefore occur through its negligence it would be obliged to recompense the pledgor.

6. What use can a pledgee make of a pledge? This depends on the reasonable intention of the parties. If the pledge consists of goods, stocks or other valuable securities yielding dividends and profits, or a herd of cattle, the pledgee certainly cannot avail himself of the dividends or profits except to discharge, so far as these may go, the pledgor's indebtedness to himself.

7. The pledgee may transfer or assign the debt and security to other parties. He may deliver them into the hands of a stranger for safe custody, or he may convey his interest conditionally by way of a pledge

to another person. In so doing his security is never destroyed nor impaired. On the other hand, by such an assignment or transfer he cannot affect in any way the rights of the pledgor.

It is true that some things cannot be assigned or put into the hands of another; for example, valuable paintings or precious stones. Just where the line runs is not always clear. In the way of a general principle, it may be said that a pledge, unless it contains a reservation, may be repledged to another.

8. The pledgor has some rights left in the pledged property. He may sell or assign it, subject to the rights of the pledgee. The vendee stands in the pledgor's place, can redeem the pledge, and hold the pledgee to account.

9. The pledgee's security is not affected by the bankruptcy or death of the pledgor.

10. There can be no valid pledge or transfer of title unless the owner has either expressly or implicitly assented to the transfer; merely because one happens to be in the possession of goods as their keeper gives him no power to pledge them for his own debt or engagement. Thus, should the bailee of a yoke of oxen, in a fit of wickedness, pledge them as security for his debt to another, the true owner could recover them from the pledgee; indeed, from anyone to whom they might be sold by the pledgee or subsequent possessor.

11. To this rule must be noted one exception; the law prescribes a different rule for negotiable paper in order to give it freer wing. Sometimes the holder

pledges it to another as security for a loan or other purpose. Such a pledgee, acting in good faith, not knowing that it belongs to another, acquires a good title. Though this is the rule, the courts often regard these transactions with suspicion. If there is any reason to suppose that the pledgee has some knowledge or suspicion that the notes, stocks, or bonds belong to another, he cannot hold them as against the true owner. Not infrequently a bank officer indulges in speculation, and to secure his loans, sends his broker stocks or negotiable securities belonging to the bank, or to its customers. The courts do not hesitate to uphold the loans and to preserve the title of the pledgee to the securities thus received in good faith by the broker without any suspicion attaching to them. But, we repeat, courts guard these transactions very carefully. The very office held by a bank official ought to be enough in some cases to lead a broker to suspect that he has sent other securities than his own. This is especially so for heavy loans and extending over long periods; especially in speculations or gambles that result disastrously to the officer.

12. Stock delivered as collateral (*a*) is presumed to be the pledgor's own property, until the contrary is shown. The bonds of a customer, therefore, deposited by a broker as collateral security for his individual indebtedness, without any notice of their true ownership, may be retained for the loan. But their transfer by the pledgee to his own name by virtue of a power of attorney, as a precaution, does not destroy the pledgor's title.

(*b*) Some difficult questions have arisen in assessing collaterals. Who shall be assessed? The general rule is, the pledgee is the legal owner, and if the stock still stands in his name he is the proper person to assess. Sometimes he avoids liability by suffering the title to remain in the name of the pledgor. This is not always done, for the reason that the pledgee's ownership or control may be thereby imperilled. So he prefers to run the risk of loss through insolvency of the issuer than the risk through the pledgor's retention of ownership.

In assessing pledged stock, though the truth has been often shown that the pledgee was nothing more, he has often been required to pay the assessment. The courts have declared that the statute ordering the assessment was imperative, requiring the person having the *legal* title to pay, and, as this was held by the pledgee, he could not escape.[1]

It has therefore proved somewhat difficult to secure the pledgee on the one hand, and yet relieve him of liability to assessment for the indebtedness of the company issuing the stock, on the other. A satisfactory way has at last been found when the fact clearly appears that the stock is pledged simply as security, and that the pledgee does not intend thereby to be legal owner or holder, except to the extent of securing his debt. The law now looks at the real transaction in its true light, and subjects the pledgor to assessment.

(*c*) Occasionally the question arises whether col-

[1]See Morawetz on Private Corporations, Chap. 1, § § 1, 32.

laterals given to secure notes may be kept to secure renewals and advancements. Of course, when a note is renewed on the security of a collateral security the holder is also a bona fide holder of the collateral. Furthermore, an alleged misapplication of collateral security is waived by giving a new note for the original loan without objection or abatement.

13. The pledgee may hold various collaterals and avail himself of any of them as long as the debt is unpaid.

14. Again, a creditor who receives collateral security from a third person is bound, on accepting it, to preserve the original debt, for in equity the third person, who thus delivers the security, is entitled to the original debt as security for himself.

15. After the maturity of the debt the pledgor must pay, or the pledgee can acquire, a complete title to the pledge. Generally, the contract carefully prescribes what the pledgee must do with the security. It must be sold in a specified manner, usually by public sale, or within a prescribed period, or at the discretion of the pledgee, and the proceeds be applied to discharge the pledgor's obligation.

16. The notice of sale must be reasonable. As the remedy is very summary, the opportunity to redeem is permitted to the last; or, if the debtor is unable to accomplish this desirable end, he may have the opportunity to secure the attendance of bidders to prevent the sacrifice of his property or of a collusive sale to interested parties.

17. The pledgee must faithfully exercise his author-

ity. He is not bound to obtain the highest possible price, but is bound to exercise common business prudence and good faith. The temptation is often great to take advantage of his situation and obtain the security at less than its real worth. The law brands such action as corrupt and indefensible, and will promptly set it aside.

18. In many cases loans are made by banks on the pledge of stocks, bonds and other securities listed in the stock exchanges. The contract provides that, in the event of non-payment by the pledgor, the security shall be sold at open board in the market, thus preventing all possibility of committing any fraud on the pledgor. Consequently there are fewer cases of fraudulent dealings with pledgors than formerly.

In perhaps all the states there are statutes regulating the mode of selling pledged property; of course these must be followed wherever they exist.

A creditor who sells collaterals at public sale, and buys them for himself, holds them as he did before, as security only. A judicial sale only, or the right reserved to purchase, will destroy the equity of redemption.

19. For a balance still due by a pledgor after the sale of his security, he is liable; should there be a balance in his favour the pledgee must return it to him.

20. Sometimes it is impossible for the pledgee to sell the securities at a price equal to the debt, and he makes a subsequent agreement to take them in full discharge of the pledgor's indebtedness. By such an agreement of course the pledgee's title to the property is complete; should its value afterward increase the

pledgor has no further claim or right of redress against the pledgee.

21. The necessary expenses of selling a pledge are chargeable to the pledgor. But when an instrument describing the terms of a pledge also provides for its sale and the application of the proceeds to the payment of the debt, "and all necessary expenses and charges," the counsel fee for the trial of a cause pertaining to the instrument itself is not included.

22. The pledgee may sue the pledgor instead of enforcing the security. The pledgee must, however, fulfil the conditions of his engagement and sell the property, provided the contract requires such action.

23. A pledgor is entitled to a restoration of his property whenever he has fulfilled his part of the agreement, or offered to fulfil it. On tendering the amount due at the appointed time the pledgee must surrender the property or become liable for its conversion unless he can show a good reason for his denial. Nor is the debtor's unwillingness to pay the debt of another person any justification for retaining the property.

24. What, then, is a diversion? A pledgee cannot deliver a collateral security to another, nor can it be held as security for subsequent advances.

25. A pledged security must be returned on payment of the debt.

26. A pledgee may relinquish collateral security given him by his debtor, regardless of the consent of other creditors, without losing his right to proceed against the debtor's property. And when money is advanced after the sale of the property pledged, the

claim of the advancing creditor is not affected by the action of the pledgee in parting with the property.

27. Pledges to pawnbrokers have been regulated by many of the states. The pledgor's condition for money often leads pawnbrokers to exact excessive rates of interest or security; consequently the states have regulated more strictly their business than that of banks and other money lenders.

By the common law goods pawned or pledged and in the pledgor's possession cannot be taken by a pledgor's creditor. This is the rule everywhere, so long at least as the pledgee's title or interest remains unextinguished.

§ 3. The Rights of Lienors

1. What is a lien.
2. Equitable lien.
3. Statutory lien.
4. Particular and general liens defined.
5. How a particular lien is created.
6. How a general lien is created.
7. A lien cannot arise from one's own wrong.
8. Lien of a carrier.
9. Warehousemen:
   - *a.*— Defined,
   - *b.*— How lien is created,
   - *c.*—His receipt for property received,
   - *d.*—What receipt contains,
   - *e.*— Is not negotiable,
   - *f.*— Except by statute,

g.— Warehousemen cannot impeach it,
h.— He can insure property.

10. Wharfinger:
a.— Wharfinger defined,
b.— His responsibility for goods,
c.— Notice of delivery to him.

11. Factor.

12. Banker.

13. Attorney.

14. Innkeeper:
a.— Compensation,
b.— Lien on minor,
c.— Lien on property of others in a guest's possession,
d.— Lien on animate property,
e.— Mode of selling property to satisfy lien,
f.— How lien may be lost.

15. Boarding-house keeper.

1. A lien is a claim of a person on the property of another, as a security for some debt or demand. The right to hold or retain property by lien lasts until the debt or demand is secured.

2. The law recognises various kinds of liens. One kind is an equitable lien, of which mention has been made when treating of the law of the sale of real property.

3. Another lien is known as a maritime lien, and has been considered in another place. A third kind of lien is known as statutory, and this plays an important part in modern law. Statutory liens of various kinds have

been established, but the one with which all are most familar is known as a mechanic's lien, whereby mechanics, workmen on buildings, as well as those who furnish the materials used in constructing or repairing them, have a lien thereon for the value of their materials or services. Another kind of lien is known as the common law lien, which is the most primitive of all. It is a legal right to retain possession of the thing to which it pertains until the debt or charge is paid.

4. The common law lien is again divided into general and particular. A general lien is a right to retain another's property for a general balance of account. A particular lien is the right to retain property on account of labour and expense bestowed on that identical property. Such a lien has long been favoured in the law. Common carriers, innkeepers, attorneys and the like have a particular lien.

More generally every bailee for hire who has added value to goods by any service has a lien thereon to a reasonable amount. The lien extends to all trades or occupations — tailors, dyers, millers, wharfingers, warehousemen and the like. One who keeps and trains a race-horse has a lien thereon for keeping and improving the animal. But neither a livery-stable keeper nor a cattle-keeper has a lien on animals delivered to him for keeping without a special agreement. By statute the lien exists in some states.

Custom is sometimes quite important in determining the nature and extent of a lien. A particular lien may be created or destroyed by agreement.

5. Particular liens can be created by express contract. They also exist under some circumstances. While the finder of lost property on land, unlike the finder of maritime property, cannot claim a lien for taking care of it for the loser, yet a finder who is promised a reward for his discovery has a lien on the property for his service.[1]

6. A general lien, like a particular lien, may arise by express agreement. Carriers and innkeepers occasionally try to limit their responsibility, and increase their lien security by general notice, but the courts are not inclined to favour these departures from ordinary methods.[2]

7. A lien cannot arise from one's own wrong; for example, on a certificate of stock held through a breach of trust. Nor can the owner be deprived of his property without his knowledge or consent, personally or through his agent.

8. The lien of a carrier covers the goods he carries, and unless he has made a special contract to deliver them before receiving payment for his service, he can retain them until the charge is paid. The lien also covers advances to others for freight and storage on the goods; but it does not include former unpaid charges, nor any other indebtedness. He also has a lien on the baggage of a passenger for his fare, but no lien on the passenger himself.

9. (*a*) Warehousemen have been defined to be persons who receive goods and merchandise to store in

[1] See Vol. III, § 20, p. 782.
[2] See Vol: II, § 17, p. 535.

warehouses for hire. The persons who follow this business of storing grain, furniture, etc., have a lien thereon for the service they render.

(*b*) To create the lien, as in other cases, the property must come fully into the possession of the warehouseman, so that it may be controlled by him or by his agent. It need not be actually in his warehouse, but it must be on his premises and under his control.

(*c*) On receipt of the property the bailor should deliver to the owner a receipt for the same. No particular form of receipt is required; usually it contains the date of the property received, a description, from whom, and an agreement to redeliver on demand to the bailor or to his order.

(*d*) It is quite common for the receipt to contain an agreement providing how the property shall be kept and the amount to be charged, also that a lien shall exist thereon for the payment of the services rendered. This agreement or stipulation is, in truth, a real contract. Many persons have taken these receipts, thinking or believing they possessed simply this character. They have often proved to such persons to have been costly delusions. On numberless occasions the courts have declared that they were contracts, binding on both parties, and relieving warehousemen from any risks or liability which the bailor had innocently supposed the other had assumed. The chief limitation placed on shipping receipts by the courts is exemption from negligence, no matter how specific the stipulation may be. In some states, notably New York, even this rule has been relaxed and bailees

may exempt themselves from all liability whatever by an express contract founded on a proper consideration.

(*e*) A warehouse receipt is not a negotiable instrument, except by statute. Nevertheless it is often indorsed and a certain kind of negotiability is attached thereto. It is often pledged as security for a loan.

Again, it is often transferred as if it were a negotiable instrument; nevertheless, technically it is not one; yet on the delivery of such a receipt to a bank as security for a loan, the title of the property therein described is transferred as effectively as it could be by the actual delivery and retention of the property itself.

(*f*) By statute in many states a warehouse receipt is made negotiable. The statutes provide that it may be transferred by indorsement and delivery, that the indorsement may be either in blank or to the order of another, and shall be deemed a warranty that the indorser has a good title and lawful authority to sell the property named therein. It also provides that the transfer of the property by negotiating the receipt shall be subject to a lien of the warehouseman for charges and advances.

(*g*) A warehouseman is not permitted to impeach his receipt. He is not permitted to show that the property received was not of the kind represented. If he did not know it was his duty to ascertain the truth before receiving the property. It would be a dangerous principle to permit him to set aside his own authority or warranty unless he could show that some fraud had been practised on him.

(*h*) A warehouseman has an insurable interest in the property confided to his care. Justice Gray has declared that "by the law any person has an insurable interest in property by the existence of which he receives a benefit, or by the destruction of which he will suffer a loss, whether he has or has not any title in or lien upon or possession of the property itself."[1]

10. A wharfinger maintains a wharf for receiving goods for hire. (*a*) His duties and liabilities are not unlike those of a warehouseman. Like him, he is liable for any loss happening through his neglect to exercise ordinary diligence.

(*b*) He cannot be charged with responsibility for goods until they are put within his control. A mere delivery of them at the wharf is not necessarily a delivery to the wharfinger. The usages of business are important to show when he acquires and ceases to have the custody of merchandise.

(*c*) In some places the usages of business require that he should be notified of the delivery of the goods to him; in truth, this usage is very general.

11. A factor or commission merchant is also a bailee for he has the custody of the property he is authorised to sell. He must use ordinary diligence, and consequently is liable for ordinary negligence. He must exercise good faith in caring for the property and performing his duty as bailee. He can sell the property, but is not authorised to pawn, pledge or mortgage it. He guarantees to possess the skill and ability of ordi-

[1] Eastern Railroad v. Relief Fire Ins. Co., 98 Mass., 423.

nary factors; his liability, therefore, is not ended simply by exercising good faith.

He must follow implicitly the directions of his consignor. If there are none then he must take good care of the property and dispose of it as the general usages of trade require.

A factor, unlike a broker selling in the name of his principal and without possession of the property, has both a particular lien and a general lien for the balance of his general account on all the debtor's goods which remain in his hands and are subject to his control. The lien extends even to the price of the goods which the factor has sold, though he has parted with their possession. It may extend to all sums for which he has become liable for his principal or otherwise by virtue of the relation between them. The doctrine also applies to purchasing as well as to selling factors. Usually the lien of a factor prevails over an attachment by a creditor. If he has sold part of the goods he is entitled to a lien on the residue for his expenses, advances and commissions. The general lien applies only to goods received and not simply to consignments.

12. Bankers also have a general lien on the securities of their customers or on their deposits for any general balance due from them.

13. Attorneys and solicitors also have a general lien on the papers of their clients in their possession for the general balance of their professional accounts. They also have a lien on the moneys recovered in a particular action. The law is liberal in dealing with

them and provides for their protection so far that not only fees and disbursements in a particular suit may constitute a general lien on the moneys recovered in such suit, but other fees and disbursements in any other suit covered by the same retainer.

14. (*a*) The lien of an innkeeper is on all the property brought within the inn by a guest or put in the innkeeper's custody. The amount of compensation he may demand, and secure by his lien, depends on the general usage of the business in his city or other place. The amount includes the reasonable charges of friends of the guest who have been invited by him, as well as extras in the way of wines, cigars, etc.

(*b*) A guest who is a minor is liable only for necessaries. Should he order wine suppers and extravagant extras the innkeeper would have no lien on his clothes or baggage for furnishing them.

(*c*) In England the question has been much considered whether an innkeeper has a lien on the property of third persons in the possession of a guest, put by him in the temporary possession of the innkeeper. By the American rule innkeepers have a claim only on the property belonging to the guest himself. Judge Thompson says that "American courts have not hesitated to declare that a common carrier has no lien for the carriage of goods which he has innocently received from a wrong-doer without the consent of the owner, expressed or implied." He also adds, "We are satisfied that a lien of a hotel or innkeeper does not exist in such a case. We are not prepared."

he continues, "to agree with those courts which have found a plain principle of justice in the rule of law by which one man's property is confiscated to pay another man's debts."[1]

The foundation of the English rule is the service rendered in protecting the goods received by the innkeeper regardless of the person who has brought them. The courts say that, for the service thus rendered, there should be a recompense, whether the possessor was the owner or the possessor of another's property. Is not this a sound foundation for the English rule?

When a guest is a servant, agent or bailee of the owner and engaged in his business — for example, a travelling salesman — and carries his goods into the inn and puts them into the innkeeper's custody, the innkeeper has a lien thereon for keeping them.

(*d*) Likewise an innkeeper has a lien on animate property — horses or other animals — taken to his inn by the agent or servant of the owner in transacting his business, for the animals must have keeping and care and their owner derives a benefit from the innkeeper's service.

(*e*) In almost all of the states the lien of an innkeeper on the goods of his guests for compensation is regulated by statute. They also provide for the mode of selling them and satisfying the innkeeper for his services.

(*f*) In several ways an innkeeper may lose or waive

[1] Wyckoff v. Southern Hotel Co., 24 Mo. App., 382, 390, 391.

his lien. First, by tendering to him his property charges; second, by his refusal to deliver the property on other grounds than that of non-payment of his compensation and his lien on the goods; third, by his agreement to give credit to the guest, for this would be inconsistent with the enforcement of the lien.

If an innkeeper once parts with the possession of his property voluntarily, or loses or waives his lien it cannot be revived by regaining or assuming possession.

15. Lastly the right of a lienor does not extend to boarding-house keepers, because they are not required to receive guests, like hotel or innkeepers. The latter are engaged in a public duty; boarding-house keepers are not. But by statute, boarding-house keepers in some states have the same rights as innkeepers.

§ 4. Bailor and Bailee

1. Definition.
2. Contract must be for a legal purpose.
3. Who can make a bailment contract.
4. What property can be bailed. Must be put into bailee's possession.
5. Bailor need not be absolute owner. He may be a thief.
6. What bailor can still do with property.
7. Bailor must tell bailee of its condition.
8. When is the transaction a sale and not a bailment.
9. Bailments classified.
10. Object of classifying.

11. What care bailee must exercise:
    - *a.*— Care required of one not receiving a reward,
    - *b.*— Every case must be judged independently,
    - *c.*— Classification of decisive circumstances,
    - *d.*— Rule applicable to bailor who knows that bailee is negligent with his own property,
    - *e.*— Care must keep pace with improvements,
    - *f.*— Contributory negligence by bailor.
12. Bailee's right to use property.
13. Bailee's right to recover property when taken from him.
14. How a bailment may cease.
15. What skill must be rendered.
16. Bailee must return property after performing the object of bailment.
17. When specific property need not be returned.
18. Excuse for non-return.
19. Bailee's lien.
20. Bailee's lien when he is a finder.
21. Bailee may assign property.
22. Rights of parties when bailee adds to the value of the property.
23. When is the transaction a bailment or partnership.
24. Consequences of loss by fire, etc.
25. Failure to do work properly:
    - *a.*— When the bailee can recover partial compensation,
    - *b.*— Effect of abandonment by bailee,
    - *c.*— Bailee can recover when bailor is at fault,
    - *d.*— Failure to perform through inevitable accident.

26. Bailee may do the work by agency of others. Exceptions.
27. When the bailor must make his claims for damage.
28. Cold storage.

1. Let us begin with a definition. Story's perhaps is more frequently quoted than any other. It is, "A delivery of a thing in trust for some special object or purpose and upon a contract, expressed or implied, to conform to the objects or purposes of the trust."

2. The contract of bailment must be for a legal purpose; were it for any other the law would not recognise the relationship or protect either party seeking to enforce the contract.

3. Any person who is competent to make a contract may become a party to a bailment. While an infant or married woman could not, at common law, make such a contract yet if property should come into her possession, the law would require her to exercise proper care of it; she could not destroy, injure or misappropriate it. A minor who should hire a horse and carriage to drive to a place, and, without authority, should drive beyond and rashly, killing the horse, would be liable for the value of the property thus wantonly destroyed. A corporation may become a bailor or a bailee. From its very nature it must act through officials or agents. And an agent, unless acting wholly beyond his authority, may create a bailment relation for his principal.

4. To create the relation of bailment the property must be of a nature capable of delivery to the bailee.

Furthermore, there must be a delivery on the one side and an acceptance on the other.

While this is true in most cases, it occasionally happens that property comes into the possession of a bailee in other ways. One may find property — a pocketbook, for example; the happy finder is by no means the owner, simply a bailee for the owner. In this case no contract exists except the one implied by the law that the finder will retain the thing and exercise due care in keeping it. What his duty may be in the way of trying to find the owner will be considered hereafter.

5. A bailor need not have an absolute title or ownership of the property. He must have a possessory right to the thing; having this he can give its care and custody to another. A bailor, for example, may simply be a lessee, yet he would then have the rights, under some conditions, of keeping the property, previously in the possession of the lessor, as bailee.

As bailment is founded on the right of possession a thief may make a bailment of stolen property. Furthermore, if the owner does not interfere, the thief may recover the bailment, should the bailee, on the termination of the relation, refuse to deliver it. A bailee cannot destroy a bailor's title.

6. The bailor can sell or encumber property while in the possession of the bailee. He may mortgage it, or in any other way encumber it and the bailee must respect the rights of the purchaser or mortgagee.

7. It is the bailor's duty to exercise good faith

toward the bailee in giving him notice of all the faults inhering in the thing bailed which may expose the bailee to danger. For example, it would be the duty of a bailor, who should loan a vicious horse, to notify the bailee of his bad character. Should the bailor fail to do so he would be liable for the consequences.

8. The question has sometimes arisen whether the transaction is a bailment or a sale. It would seem as though this question ought to be common in everyday business, because the two contracts are so different in their nature; nevertheless the courts are occasionally required to answer this question. If the identical property is to be returned, or the same property in a changed condition, or the natural product of the same property, the transaction is not a sale. One well-known test, says Benjamin, between a bailment and a sale is that when the identical thing delivered is to be returned, though perhaps in an altered form, it is a bailment and the title is not changed, but when there is no obligation to return the specified article received, and the receiver is at liberty to return another thing, either in the same or some other form, or else to pay money, he becomes a purchaser. Thus, when casts were delivered to be manufactured into shears, the plates to be furnished by the bailee, this was held to be a bailment.

9. Much difficulty has arisen in classifying bailments. For our purpose, however, we will divide them into three classes. First, things delivered to a bailee purely for his accommodation; second, things purely

for the accommodation of the bailor; third, things for the benefit of both parties. Examples may be readily enough furnished of each transaction. A person, for example, borrows a knife of another or some utensil for his own individual use. This is loaned to him not for any reward, but purely as an accommodation. Again, a bond received by a bank to keep for a depositor for which no compensation is expected or paid is a bailment of the second class. An example of the third class may be given of cattle which are put for safekeeping into the possession of another, who is to be paid for the service rendered. Both parties are the gainers, and this is their intent in changing the possession of the cattle.

10. The chief importance of classifying bailments is to determine the degree of care that should be exercised by the bailee in keeping them, or evidently, when a bailee is not to receive a reward, the act being purely gratuitous on his part, a much less degree of care is required than when the opposite conditions between the parties exist. Thus, a safe-deposit company, established to receive deposits and receive a reward for its service, must exercise the highest degree of care in keeping them. A bailee may greatly lessen his liability by special agreement; indeed, in some states, may be entirely released.

11. From the earliest days there has been the greatest difficulty in determining what degree of care should be exercised in these matters. About the only line of agreement is, that a less degree of care is required of a bailee who is to receive nothing for the service

than of one who is to be rewarded. But where shall the line between the different classes be drawn?

(*a*) Perhaps a statement more frequently reiterated than any other is that a bailee who serves without reward ought to exercise the same degree of care that is exercised by a prudent man in keeping a thing of his own of a similar nature. Assuming this rule to be correct, then the question in every case is, do the the facts come within it rendering a bailee liable, or not? Consequently every case must be determined by itself and the law can impose no rule the application of which is always the same, or self-evident. In other words, the rule of law, whatever it may be, is one of varying difficulty in its application, because the facts are dissimilar pertaining to the bailment.

This may be illustrated in the keeping of securities by banks for their customers. As is well known, it is a common practice of banks to accommodate their customers in this way, especially country banks where safe places for keeping things are not as numerous as in the large cities. Every now and then bonds or other securities have been lost or taken and the bailor has sought to recover from the bank. How have the courts decided? Generally they have told the jury that they must apply the rule above mentioned, and then left them to decide whether, in the light of this rule, the bank was negligent or not.

A bank is no more responsible for a loss by the theft of one of its employees than for a loss occasioned by an unknown person. This may seem a hard doctrine, but its reasonableness will soon appear. A

famous case occurred in Massachusetts many years ago of the loss of a keg of gold stolen by the cashier. The fact was clearly enough proved that the cashier had stolen it, and the bailor tried to hold the bank responsible therefor. The court said nay, declaring that the cashier was not employed by the bank to steal, and therefore it could not be held liable unless it had some reason to doubt his honesty or integrity. If a bank should employ a servant whose honesty was suspected then, indeed, it would be responsible for the consequences, not otherwise. Everywhere a bank seeks to employ only trustworthy servants, and if it is occasionally misled it is free from responsibility to an ordinary bailor who has given no reward or recompense to the institution for keeping his securities.

Such is the ordinary rule. Attempts have been made to show that the profits derived from keeping a depositor's account are a sufficient consideration for a contract of bailment to which a more stringent rule of liability may be applied. The courts have lent no countenance to this contention, and so the rule of law everywhere is that such bailments are of a purely gratuitous character, and the bank is not liable for their loss when exercising ordinary diligence.

(*b*) The latest authority on the subject has remarked that every case must be ruled by its own facts and circumstances. The advent of every new invention, the discovery of every new and important force that is appropriated by man and made subservient to the great on-marching industries in these days of progress,

bring with them new and varied circumstances and conditions which must be considered in defining and determining what is negligence and what is diligence in a given case.

(*c*) The circumstances that may be decisive of the care exercised by a bailee may be thus classified; First, the nature and value of the article; second, the customs of the place of trade; third, the conditions of the country or climate; fourth, the condition of the times.

Of the first class of cases it may be said that one in charge of heavy and immovable articles would not be deemed guilty of negligence should he leave them out of doors unguarded overnight, while a very different rule would apply to a jeweler who was acting as bailee of valuable diamonds and precious stones. Again, the customs or place of trade are often valuable signs or guides for determining the degree of care that should be exercised by a bailee.

(*d*) While the rule of ordinary diligence applies in all cases, and a much stricter rule when a consideration is paid for the bailment, an exception must be made in cases wherein the bailor knows that the bailee is neglectful concerning the management of his own property. When a bailment is gratuitous, and the bailor knows of the bailee's way of doing business, it is not rational to suppose that he will exercise a higher degree of care of others' property than of his own. In such cases therefore a still lower level will suffice to fix the liability of the bailee. It is true that the courts are not uniform in their application of rules,

some of them holding that while a person may be negligent in managing his own affairs, he should not be when managing the affairs of another, even though he is to receive no reward for his service.

(*e*) Again diligence must keep pace with improvements; and though dangers thicken with civilisation, so do the means improve of preventing losses, and these must be utilised to overcome danger. A recent authority has remarked that a custodian for hire is bound to keep pace with the advanced requirements and practices of his class. If he does this he escapes liability for loss or injury that comes to the property entrusted to him; if he does not he has failed to be ordinarily diligent and is liable for the damages that result through his failure. It is true that a bailee is not obliged to adopt the very best and newest appliances to secure the protection of his customers, but he must be ordinarily prudent in their use.

(*f*) Sometimes the bailor himself has been negligent in caring for the thing lost or injured. In such cases clear proof of his contributory negligence may be a good defence to an action for the loss or injury of his property.

12. In using the property the general rule is a bailee must act simply as a keeper. To this rule there are some exceptions. Thus, were a milk cow put into the possession of a bailee, it would be his duty to have her milked; or a flock of sheep near shearing time, to have them sheared.

The law implies that the bailee will put the property to its natural and ordinary use, and if in so

using it, he is put to expense, the bailor is required to reimburse him. For example, the natural use of a horse requires the feeding and shoeing of the animal, or, if taken sick, attention by a veterinary. When these things are done the expense must be refunded by the bailor.

Should the bailee use the property confided to him in an unwarranted manner he would be liable therefor. What this may be of course depends on his use of it. Sometimes the contract of bailment prescribes how the property may be used or kept. For example, to put a fine carriage team, left with the bailee for the purpose of pleasure driving, to the plow or to hard work on a farm, would be an unauthorised use.

13. The bailee only has a possessory title to the bailed property. Nevertheless he can bring an action for its recovery should it get out of his possession, or trover for its value.

14. A bailment may cease in several ways. First, by the expiration of the time for which the property was bailed; second, by the attainment of the object for which the bailment was made; third, by demand on the part of the bailor; fourth, by operation of law; fifth, by destruction of the bailed property; sixth, by the death of the bailee; seventh, by the incompetence of either party to continue the relationship. For example, should the bailee become insane or habitually drunk, or otherwise unfitted to exercise the duties he has undertaken.

15. Although the bailee is to receive no compensation, he must render the kind of service concerning the

thing bailed which he holds out to the public he is competent to perform. Thus, a skilled watchmaker who receives a watch for repairs, even though he has promised to do the work for nothing, must render the service he is capable of rendering; to do otherwise would be gross negligence. This rule is of wide application. The skill must be proportioned to the kind of work required. Thus, a painter or a diamond cutter must exercise the skill of a person in that particular capacity, and the law will be satisfied with nothing less. This principle has sometimes been applied to dressmakers in which they have sought to employ others less skilled than themselves in the making of garments. In such cases, wherein the personal skill and attention of the person employed was expected, the law is not satisfied either by trusting the work to another or by exercising less skill and ingenuity than is customarily exercised by the particular person or persons who do such work.

16. It is the duty of the bailee, after accomplishing the object of the bailment, to return the property to the bailor, or to a person designated by him, with all accessions thereto while in his possession. If the bailee refuses to do this without legal excuse the law regards him as having converted the property to his own use; and the bailor can either recover the value thereof, or bring a specific action, replevin, to recover the property itself.

17. The bailee has the right to the possession while the bailment continues; afterward the bailor has a reversionary interest in the property; he is

entitled to its redelivery at the expiration of the contract in as good condition as it was at the time of taking possession, with due regard to the ordinary results of keeping. It follows, therefore, that the bailor has a right to defend his title of the property and to sustain an action against third persons, and even against the bailee for any trespass or use that is injurious to the property, which may depreciate its value or cause its destruction.

It is true that in many cases the bailee is not required to return the specific property, but may return other property of the same kind and quality. Thus, wheat may be put into a common receiver, an elevator, and the contract of bailment is properly executed by delivering to the bailor at the required time wheat of similar quantity and quality. Again, wheat may be delivered to a mill to be made into flour, and the contract is properly performed by delivering to the bailor the proper quantity of flour of the same grade or quality as would have been manufactured by using the bailor's specific grain.

18. For the non-return of the property there may be some excuse; it may have been destroyed or lost without the bailee's fault. Again, it may have been delivered to another who proved himself to be the true owner; or again, the bailee may have been deprived of the property by due process of law, and therefore could not deliver it to the bailor. But if the bailee has no valid excuse of his own, on the expiration of the term of bailment it is his duty to deliver the property in proper condition.

19. The bailee has a lien on the property for his services. In many cases the compensation is fixed by agreement or law; in these there is no implied agreement or lien for compensation. In other words, an express agreement supplants the lien created by law.

The bailee, though having a lien on the property bailed, for its care and preservation, has no security for any other debt or obligation due from the bailor; the lien is confined exclusively to the care of the particular property in his charge.

Even if there be a mortgage on the property at the time of the bailment, a bailee's lien may have priority. This is true in those cases wherein it is necessary to repair the property in order to preserve it and render it useful. In other words, necessity creates a prior lien. Thus, on one occasion it was necessary to repair a canal boat, otherwise she would have become valueless. The bailee did so and the court held that he had a prior lien over the mortgagee for the expense thus incurred. The court remarked that the mortgagee having allowed the owner to continue in the apparent ownership of the boat, making her a source of profit and a means wherewith to pay off the mortgaged debt, the relation was created by implication entitling the owner to do all that might be necessary to keep her in an efficient state. It was as much to the advantage of the mortgagee as to that of the mortgagor or owner to have the repairs made and the boat preserved for navigation, and so the bailee's priority of lien prevailed.

20. A finder who lawfully comes into the possession of property becomes the bailee; and if he bestows any labour thereon, in good faith, which is essential to its preservation, he has a lien for the service thus rendered. It would seem as though an owner ought to be willing to make compensation in such cases, but the world is full of mean people, and so this question has arisen and has been thus answered. In one of the cases a boat was found adrift with holes in the bottom and in danger of sinking. The finder made such repairs as were needful to keep her afloat, nevertheless the owner was unwilling to pay for them. The court decided very properly that as they were necessary for the protection of the property, the owner must pay before he could demand his boat.

21. A bailee under some circumstances has a right to assign the bailment to another. This rule has only a limited application, for in most cases the bailment is a confidential relation, one of trust, that is made because of the known character and fitness of the bailee. One of the cases in which this can be done is in subletting a lease whereby the farming implements and stock on the farm go to the bailee.

22. On many occasions materials are put into the possession of another for the purpose of having work done on them. Thus, a man delivers hides to another to be tanned into leather. The tanner is to use his skill in converting the hides into leather, and in so doing exercises an important part in giving additional value to the materials. Important practical questions have arisen concerning the ownership of such property,

and we will state the rules governing the parties to such arrangements.

While there is no fixed or settled rule respecting the proportion of the material the bailor or employer must furnish in order to establish the bailment relation, it is admitted that he must furnish the principal part of the materials to establish such a relation between them.

In these cases the bailee has a special property in the thing bailed, because he mingles with the property of the bailor other materials and labour of his own and thus becomes a kind of part owner as well as actual possessor and creator of the property. This situation of the two parties renders the relation peculiar, giving the bailee a larger right or interest in the property than in other property wherein the bailee has no especial interest in the way of improving or creating it. Hence it follows, that as the bailment advances, the interest of the bailee must increase in value, consequently he may maintain an action to recover the value, or replevin to recover the property itself against one who deprived him of it, whoever he may be.

23. Sometimes in thus producing a thing jointly that is to be sold in the market, followed by a division of the net profits, the question has arisen, is the relation between the two a bailment or a partnership? In a recent case a court in New York held that the relation was that of bailment.

When no express contract exists to determine the rights of the parties, a recent and excellent writer has said that the law has established the following prin-

ciples:[1] First, the bailor must do everything consistent with the employment to be performed on his part to enable the workmen to execute the engagement; second, to pay for all necessary and new materials; third, to pay the price or compensation that is to be paid for the work as agreed; fourth, to accept the thing when it is finished. On the part of the bailee the law requires: First, that he should receive, care for and keep all material furnished until the contract is carried out or is terminated; second, to perform the service in good faith and as required by the undertaking; third, to do the work and produce the result of the undertaking within the time agreed; fourth, to use the skill and judgment required and which the workman promised to use upon the subject matter of the bailment; fifth, to use and employ the material in the proper manner; sixth, to exercise good faith and honest dealing in carrying out the undertaking; seventh, to exercise that degree of diligence in all forms of the service and in using the material and accomplishing the object of the undertaking that is required by law in such like cases; eighth, to deliver the property to the bailor when the bailment contract is fulfilled or otherwise terminated.

24. If the thing is destroyed during the execution of the agreement, who is the loser? Should the property be destroyed at any time by reason of internal defects, inevitable accident or irresistible force, outside the negligence of the bailee, or his workman, the loss would be the bailor's. The reason is because

[1] Van Zile on Bailments, § 137, p. 83.

the property at the time of the loss is that of the bailor with all the labour and new material added. It therefore follows that the workmen would be entitled to recover from the bailor compensation for the labour he had bestowed on the materials to the time of its destruction.

The rule would be very different if a workman furnished all the materials and all the labour and was to produce for the employer manufactured articles. In such a case were they destroyed in process of manufacture, or after their completion and before delivery, the workman could recover no compensation from the employer for his labour and materials for the very good reason that the property would not belong to the purchaser, but wholly to the workman.

Justice Story has thus stated the rule: "If the work is independent of any materials or property of the employer, the manufacturer has the risk and the unfinished work perishes to him. If the bailee is employed in working up the materials or adding his labour to the property of the employer, the risk is with the owner of the thing with which the labour is incorporated." [1]

Suppose there is a contract to do work at a stipulated price for the entire undertaking, and that the thing should accidentally perish or be destroyed, without any fault on either side, before the completion of the work. Would the workman be entitled to compensation *pro tanto* for his work and labour done and materials applied to the time of the loss or des-

[1] Bailments, § 426.

truction? By the common law the workman is not entitled to compensation. The thing would perish to the employer and the work to the mechanic, for the contract would be treated as an entirety.

25. Of course a bailor is entitled to have the work done as the contract requires, and the bailee's failure raises no liability for compensation. If the parties stand in the relation of vendor and vendee it is the latter's duty to reject the goods because the vendor has failed to carry out the agreement. But he must act promptly, and refuse the goods, or express his dissent at once, and thus enable the vendor to protect his interest.

(*a*) There are some contingencies under which the bailee's failure to perform his contract does not deprive him entirely of compensation. If the work is so badly done that the product is of no value nothing can be recovered. If, on the other hand, the thing produced is of some value, even though it be imperfectly and ineffectually done, the workman can recover what it is actually worth to his employer.

(*b*) The cases are quite numerous in which the workman abandons his undertaking before completing it and his employer suffers a serious loss. The rule that applies in such a case has two sides or faces. If the workman has done something for his employer having a real value, notwithstanding his breach of contract, he can recover for the work and his service. Of course, there can be no recovery on the contract, for as this has been broken, the law does not recognise it in any manner whatever. It simply permits him

to recover for what he has done possessing value to the other, regardless of the contract.

On the other hand, if the workman on thus quitting his undertaking has subjected his employer to a positive loss, far more than the worth of his service, the employer can recover to the full amount of the injury he has sustained.

(*c*) If the failure to perform is the bailor's fault, of course the bailee is entitled to recover for the worth of his service. Thus, should an ageement call for the furnishing of more material, and the bailor for some reason or other fail to furnish it, whereby the bailee could not finish his undertaking, or not within the stipulated time, he would have his remedy against the other for his failure to execute his part of the contract.

(*d*) Again, a workman who is prevented by reason of inevitable accident from finishing the contract, and is in no way at fault himself, is excused, and cannot be deprived of compensation to a reasonable extent for the worth of his labour. In such case the bailee must show that he exercised ordinary care and diligence to avoid the accident which prevented him from completing the contract.

26. Generally speaking, a bailee may perform the labour expected of him through other persons, except those undertakings wherein the nature of the employment requires the skill of the person employed. For example, were an eminent artist employed to paint a portrait, he could not employ as a substitute an ordinary whitewasher. There is not much difficulty in applying the rule in these cases, as the nature of the

work shows very clearly what can be delegated to others, and what not.

27. The bailor's claim for the loss or damage must be made immediately on their delivery by the bailee. In a recent case a manufacturer sent silk braids to a dyer to be dyed. After this was done the braids were returned to the bailor who wove a part of them in the ordinary manner. A short time afterward the braids were found to be of greatly inferior value, which was due to unskilful dyeing. The dyer on returning the dyed silk sent his bill for the same on which was printed the following notice: "All claims for defects or damages must be made three days from date, otherwise no allowance." No notice was given by the manufacturer to the dyer until several months after receiving the notice. The court decided that he had not acted promptly enough, notwithstanding the imperfect character of the dyer's work, to claim compensation.

28. In closing this chapter some principles may be added that apply to cold storage, a business that is now rapidly growing in importance. A cold storage company is a bailee and, unless a special agreement exists, it must exercise ordinary prudence in preserving the merchandise entrusted to its keeping. Its nature and value also affect the question of care that must be used.

If the company's stock of ice or other means employed to maintain the temperature required for the preservation of the property is insufficient, it must replenish the supply, or give timely warning to its customers to remove their property. If neither thing

is done the company is responsible for the injury caused by its neglect.

A cold-storage company is liable for damages to eggs resulting from the escape of ammonia, or from the gases emanating from fruit stored in an adjoining room, or from a rise of temperature caused by the melting of ice and neglect in replenishing the supply.

Fruit is often stored, and its preservation depends on keeping the storehouse at a proper temperature. Consequently, if the temperature is greatly lessened and the fruit is frozen, the bailee is liable; or, if it is ruined by keeping the temperature too high. And this is said to be the law even when decay is due in part to the condition of the property at the time of storing it. The bailee's storehouse should be properly constructed for the purpose; and, if it is not, he is responsible for the consequences. And this principle may be applied to a bailee, even if the bailor knew that its construction was faulty, or had time to make an examination for himself and did not.

How far can a bailee limit his liability by an express stipulation? In one of the cases the receipt stated that "all damage to perishable property is at the owner's risk." This was held to refer to loss resulting from the inherent qualities of the property stored. In another case the receipt stated that the "company will provide any desired temperature, but will not be responsible for results." This stipulation referred exclusively to the results of the temperature. In another case a bailee received cheese which was to be kept in a dry room at a specified temperature by means

of overhead pipes filled with brine. The receipt stated that the property was to be kept at the owner's risk of loss from water. Nevertheless, the bailee was liable for damage caused by the dripping of water from the pipes resulting from the bailee's negligence.

Besides permanent structures erected for cold storage, temporary cold storage may be effected in refrigerator cars. A carrier is not required to furnish such cars for carrying perishable property. But if a carrier receives butter, for example, for transportation, it must exercise care to protect it from the heat, and carry it in improved cars if such are in use; nor can the carrier escape liability for not safely transporting it on the ground that it did not have cars sufficient for that purpose.

Again, if a common carrier accepts fruit for transportation to a distant place, and, instead of packing it in a refrigerator car, packs it in a car through which cold air and snow enter, whereby the fruit is frozen, the carrier is liable for the damage and cannot shield himself behind a bill of lading exempting him from liability for loss caused by the weather.[1]

§ 5. Trustees

1. Trustee defined.
2. Executor defined.

[1] See note on Cold Storage, 90 Am. St. Rep., 295–302. "If eggs are placed in a refrigerator car properly iced to prevent from freezing, and on arriving safely at their destinatuon are placed by the carrier in its warehouse, it is still bound to use common and ordinary prudence in storing them, and if the warehouse is not a proper place for such storage in the winter time, the carrier is guilty of negligence and liable in damages if the eggs become frozen while in such warehouse." Ibid, p. 302.

3. Administrator defined.
4. Who can be appointed executor:
   a.— Minors,
   b.— Two or more executors,
   c.— Corporations may thus act.
5. Who can be appointed administrator.
6. Appointment of executor in place of one designated by, but dying before, the testator.
7. An administrator or testator must give bonds that he will serve faithfully.
8. Administrator takes only the personal property.
9. Rule is changed in some states by statute.
10. Does the administrator take mortgages, crops, etc.
11. Gifts by the deceased.
12. When donatio mortis gift is invalid.
13. Validity of an inter vivos gift.
14. Donee may act as trustee.
15. When such a trusteeship is invalid.
16. Fraudulent conveyance by deceased to defeat creditors.
17. Administrator must make an inventory of estate.
18. Creditors must be notified to present their claims.
19. When an estate may be declared insolvent.
20. Mode of settling an insolvent estate.
21. Appointment of commissioners to pass on validity of claims.
22. Collection and distribution of assets.
23. Real estate may be taken to pay debts.
24. Expense of administering estate as insolvent should, if possible, be avoided.

25. Administrator may make temporary investment.
26. His authority to sell property.
27. Distribution of the estate.
28. Settlement of a testate estate.
29. Description of a technical trustee.
30. Trusts are shorter and less complicated than formerly.
31. Executor may be a trustee.
32. Trustee should not be a minor.
33. A trust will not fail for lack of a trustee.
34. Intermeddler in a trust estate.
35. General duties of a trustee.
36. Negligence of trustee:
    a.— In not paying taxes,
    b.— In not using the property properly,
    c.— He cannot use estate for his own profit,
    d.— He cannot pledge it for his own debt.
37. Trustee's failure does not involve trust property.
38. Trust property is liable for proper trust debts.
39. Effect of death of co-trustee.
40. Incidental duties.
41. Authority to sell and convert trust property.
42. How two or more trustees must execute their powers.
43. Trustees' authority is personal and cannot be delegated.
44. His authority to sell trust property:
    a.— Sale of real estate,
    b.— His duty to lease it,
    c.— He must keep the property insured and in good repair,

d.— Management of personal property,
e.— How property should be invested,
f.— Sale of personal property,
g.— Temporary investment of proceeds.
45. A trustee cannot pledge the trust property.
46. His authority to sue and defend suits.
47. His duty to support the beneficiary.
48. His removal.
49. His compensation.

1. The term trustee includes a great variety of persons who act for others. The cashier of a bank, or director of a railroad is often called an agent or trustee, but we propose to include in this chapter executors and administrators, and persons technically known as trustees, who thus serve in discharging many well-known duties.

2. Let us begin by defining the duties of an executor. In another chapter we have explained the nature of a will, who may make one, how it must be construed; in short, all the leading features except the execution of the testator's wishes. He usually appoints one or more persons to execute his will; and their function or purpose is to settle his estate; in other words, to execute his directions in the manner set forth in his will.

3. An administrator is a person appointed by a court, existing for that purpose, to administer or settle the estate of a person who has died intestate, or without leaving a will or direction for the settlement of his estate. The duties of an executor and an

administrator, therefore, in many respects are quite similar, and for that reason are often considered together in legal works, and accordingly we shall thus treat of them in this chapter.

4. A testator can appoint almost anyone to be his executor; his wife, one or more of his children, some friend; in short, almost any person legally capable of doing business.

(*a*) A minor is hardly a fit person though he is sometimes chosen[1]; and if a testator should appoint a person who, at the outset of his duties was mentally incapable of performing them, the court would set him aside and appoint another in his stead. The supposition clearly would be that the testator intended to appoint a person who was capable of administering the trust, and for every reason a person who should become incapable after his selection ought to be set aside, otherwise great harm might be done to every interest.

(*b*) Very often a testator appoints two or more persons as executors; this is a common practice. One object of doing so is to secure a more efficient administration of the estate, as each is supposed to contribute something in the way of ability or experience. Nevertheless, when co-executors are thus appointed, they may act in many regards separately. As we shall soon see, the rule is quite different from that which applies to technical trustees. An executor, for example, can sign a receipt or draw money from a bank on his single check as executor; while both trustees are required to sign such an instrument to make it effective.

[1] Wœrner's Am. Law of Administration, § 182, p. 433.

(*c*) Formerly, only individuals could act as executors, administrators, or trustees, but corporations are now specially authorised to act as executors, administrators, guardians, and trustees, for almost every kind of trust known to society. The most important advantage gained in appointing a corporation is responsibility. Nothing is more common than to hear of the abuse by an executor or administrator of his trust. Either through ignorance or fraud, or both, he squanders or loses the estate committed to his care. Corporations possess abundant means to respond to any mistake or negligence of which they may be guilty; and this advantage over that possessed by individuals is so great that the practice, especially among the possessors of large fortunes, is rapidly growing to appoint corporations as executors or trustees.

5. In appointing an administrator the statutes generally establish the rule. The next of kin is entitled to administer, and his relationship is ascertained in most states by the civil law; in others, by the common law. Illegitimate and adopted children have no right to administer, unless the right is given them by statute. Among grandchildren, equally near the deceased, the following rules of preference are usually followed by the courts and also by some of the states: Sole administration is preferred to joint, male to female, unmarried woman to married woman, resident to non-resident, one most interested in the estate is preferred to one having the least interest or none.

In some states the law provides for a public administrator, who shall serve whenever there is no next of kin or near representative of the deceased. In other cases creditors have the right of signifying their choice. If the estate is likely to be insolvent and its efficient administration is important to the interests of the creditors, the selection of the administrator is of the highest moment and great care should be exercised in making the appointment. In many cases the statute is literally followed, and in the case of the death of a wife her husband is appointed, or vice versa, or the children of the father, and so on without any dispute or question.

6. Sometimes a testator omits to name an executor, or perhaps he may die before the testator himself. When this happens the court will appoint one or two executors, as the case may be, who are endowed with the same authority after their appointment as if they had been appointed by the testator himself. They are called administrators with the will annexed.

7. An administrator is required by law to give a bond for the faithful performance of his duty.[1] This bond is signed by himself and one or two other persons or by a company as security. The purport of such a bond is, if he fails to administer his trust as the law prescribes, then he

[1] "In Florida, Georgia, Louisiana, New York, North Carolina, Pennsylvania and South Carolina executors are permitted to administer on the estates of their testators without giving an administration bond. In other states no distinction is made in the matter of requiring bonds between administrators and executors, unless the testator expressly direct, by provision in the will, that the executors by him appointed shall not be required to give bond, unless the court, upon complaint of some creditor, legatee or other person interested, or even upon its own knowledge, suspect that the estate would be fraudulently administered or wasted." 1 Wœrner's Am. Law of Adm., § 250, p. 570.

and his bondsmen are liable for the consequences.

A testator sometimes directs in his will that his executor need not give a bond; even when he is thus relieved, the court having jurisdiction of the settlement of his estate sometimes requires a small bond to be given. In the larger number of states executors are required to give bonds the same as administrators, and the amount in both cases is determined by the probable amount of the personal property.[1]

8. Very often a person dies leaving both real and personal estate. If he is solvent the real property vests immediately in the heir, or heirs at law, and the executor or administrator has nothing to do with it except perhaps to lease it and collect the income.[2] The title to personal property vests in the administrator, for the purpose of claims and distribution. He therefore takes possession at once, or if unable to do so he can bring a suit for this purpose. His right thereto is absolute and therefore his right of action is complete. He may bring replevin to recover the property itself, or an action of trover for its value, or any other action, as if he were in every sense the absolute owner.

9. While the real estate at common law descends to the heirs or devisees, in some states this principle is changed by statute and the executor or administrator is given control during the settlement of the estate,

[1] In some respects their duties are not the same.

[2] In many states the administrator or executor has no right whatever to lease the real estate; if he does so, more often he acts as agent for the devisees or heirs than in any other capacity.

or for such a time as may be needful to insure the payment of its debts. When he is satisfied of the existence of sufficient personal property to pay its indebtedness without resort to the real estate, then he may surrender it with due safety to himself and to the creditors.

10. There are some very difficult questions touching the property that he can, or must, take and hold for the proper administration of his trust. All personal property, of course, is vested in him, but there is a large amount of property, mortgages, and the like concerning which different rules exist. In general, a mortgage is an asset of the estate and goes to the executors or administrators; and the same thing may be said of animals, and the natural products of the land.

11. What shall be said of gifts that have been made by a testator or intestate? There are two kinds: inter vivos and causa mortis gifts. The latter kind does not become absolute; it is a peculiar kind of property.

12. A gift of this kind is invalid if needed to pay the debts of the donor, but if the estate is solvent, even then a question may arise between the donee and the executor or the administrator. He may question the validity of the gift on the ground that the act of the donor was not sufficient to constitute a valid gift. The general principle is that such a gift to be valid must be in contemplation of death, and the money or other property must have been delivered. Consequently, if there has been no deliv-

ery, the gift fails. Perhaps the largest number of gifts coming within judicial view have been made by the depositors of savings banks.

13. There is less difficulty in determining whether an inter vivos gift is valid, because there is a delivery of the thing without condition or revocation. If the gift exists at all it is complete at the time of the delivery of the thing given.

14. A donor may make a gift and still be a trustee of the property, or the gift during his lifetime. Thus, a depositor in a savings bank may make a disposition in trust for another and exercise all the duties of a trustee in the management of the property. In the case of an ordinary out-and-out gift there must be a delivery and an acceptance, but when one acts as a trustee he retains possession of the thing given. Formerly, it was said that a beneficiary must be notified about the gift, but this seems to be no longer requisite in order to make a valid donation. When the beneficiary is informed it is simply another link in the chain of evidence.

15. In many cases trusts are created, not with the intention of making an actual gift to anyone, but simply of evading some law. Thus, some of the states provide that a savings-bank depositor must be restricted in his deposits to one or two thousand dollars, and in order to evade the law he deposits the money in trust in the name of A, B, and C. As the trust is created simply to evade the law, and not to make a valid gift for the benefit of the persons named, the courts do not hesitate to declare the gift to be invalid.

16. An executor or administrator must proceed at once to recover property that has been conveyed by the deceased for the purpose of defrauding his creditors, for in administering an estate all just debts, if possible, must be paid. These must be liquidated or discharged before legacies or other sums can be paid to the heirs except in the case of a few priorities, like the priority of a wife to share in the estate of her husband. The law regards her not as a preferred creditor, but as having an estate which cannot be taken away without her consent.[1]

17. On the death of the testator, or intestate, the first duty of the executor or administrator is to make an inventory of the estate. The object of this is to find out the amount of his trust, both for his own enlightenment and for that of the court. This inventory is made by the administrator with the assistance of two or three persons called appraisers. This proceeding is not required in every state, but in most of them. Obviously, the first step in executing an estate is to know the kind of property, its worth and characteristics.

18. Having done this, the next step is to notify all creditors to present their claims, which must be done within a period prescribed by law. This is not very long, usually about six months, which experience has shown to be quite long enough. It does not follow that the exact amount of the claim must be settled within this period, but simply that notice of it

[1] "A fraudulent deed set aside at the instance of creditors cannot bar the surviving wife of dower as against the creditors or purchasers under a mere decretal sale." Dugan v. Massey, 6 Bush (Ky.), 81; 1 Wœrner § 113, p. 266.

must be given, or it will be cut off. If an estate be large and complicated there may be many disputed claims that can be settled only by judicial ascertainment. Thus, years may pass before the exact amount of the indebtedness of the deceased is fully ascertained.

19. On the death of a person, if it is known or believed that his indebtedness exceeds the amount of his property, the administrator requests the court to declare the estate insolvent, whereupon he proceeds to settle it as an insolvent estate. Sometimes he begins his work believing there is ample property to pay all claims, beside a large balance for distribution, and is greatly surprised by the presentation of unexpected claims, which, if valid, will render the estate insolvent. He then makes an application to have the estate declared insolvent and proceeds accordingly.

20. The mode of dealing with an insolvent estate is quite different in several ways from the mode of dealing with the other. In a solvent estate the administrator in some states has a wide latitude to determine the worth or validity of every claim; in other states his authority is restricted. It will be readily seen that this is a great authority to commit to an administrator, and may be abused. An unfit or incompetent administrator, or one who was bent on defrauding the estate might take advantage of his position to disallow claims; in short, to commit great wrongs.

21. For this reason some states have virtually entrusted the authority to decide the worth of claims to a court or commission. In such states an adminis-

trator's authority to deal with claims is nearly or entirely gone.

22. While creditors are presenting their claims the administrator is collecting the assets belonging to the estate. Not infrequently he is obliged to sue debtors; and several months pass before he is in a condition to pay the creditors anything. Sooner or later he succeeds in collecting the assets, and the commissioners in ascertaining the liabilities. The next step is, by virtue of an order of court, to make a dividend or allowance to creditors. Sometimes several dividends are made, the first after collecting a portion of the assets, and the second after collecting still more, and so on until all the assets have been collected and divided.

Occasionally an insolvent estate proves to be solvent, and of course all the creditors are paid in full, and the balance, if there be any remaining, is distributed as the law directs.

23. If the real estate is needed to pay the debts of the deceased, it may be taken for this purpose. It will be seen, therefore, that the heir, or devisee, who has the title and may be in possession, is not quite the absolute owner until this question is determined. If it is not needed then the title of the heir is complete in every respect, and he is as fully entitled to the possession and income as any other property he may own or possess.

24. As the expense of administering an insolvent estate is somewhat greater than that of administering a solvent one, it is preferable to carry the estate

through as solvent if this can be done. On the other hand, if it is apparent at the beginning, or at any time afterward, that it is insolvent the only course is to have its insolvency declared and to settle it accordingly.

25. In collecting the assets of the estate it may be needful for him to make a temporary investment for the purpose of adding something to the amount. He may deposit the money in a bank, and if he did so, exercising proper judgment in the selection of an institution, which afterward failed, he would not be personally responsible. He ought to receive some interest, if possible, from the temporary use of money, but in no case is he justified in retaining this as a perquisite. All the income derived from the assets of the estate, either directly or indirectly, should be added thereto. From this rule there is no exception.

26. In selling personal property he may act on his sole authority, or be governed by the statute provided for such cases. Very often he is required to make an application to the court for the sale of property belonging to the estate. Certainly this is much the safer course for him to pursue.

Sometimes the deceased was a member of a partnership, and it is very important, perhaps, to continue the business for a time at least before withdrawing the money he had invested in the enterprise. It may be, if the money were suddenly withdrawn, serious harm would result to the surviving partners, or perhaps the full amount could not be obtained belonging to the deceased. At all events the interests

of both parties are often best served by continuing for a time the business. In such cases an executor or administrator may possibly have to take a large personal risk himself, as the court may have no authority to permit him to act temporarily as partner in place of the testator or intestate. In some states experience has shown the need of endowing an administrator or an executor with authority to act thus for a short period, and power has been given him accordingly. Whenever it does not exist he acts wholly on his own responsibility. When thus acting it is certainly his most prudent course to inform the court, and if it cannot shield him in any manner, his notification will tend to show his good intention, at least, in thus continuing to act temporarily as substituted partner.

27. Finally, after collecting the assets, paying the bills, and dividing partly or wholly the estate, errors may be discovered, or still worse, frauds. In such cases the estate may be opened for further action. It is a familiar principle of law that a statute of limitations does not run against a fraud. In other words, whenever a fraud has been discovered in the settlement of an estate, or in the execution of any trust, the persons interested have a specified period of time, several years at least, after their discovery, to take action against the wrong-doers. Should the persons thus interested neglect, however, to take action within the period prescribed, then the fault would be their own and their remedy would be cut off. It therefore happens that estates are opened either for one or both

of these reasons years after final settlement, but when at last a settlement is reached then the statute of limitations becomes operative to bind all the parties interested; and after the statute has run for the period appointed the estate or trust is closed and all possibility of future action is ended.

28. In a testate estate the testator himself has directed the mode of distribution. But it must not be forgotten that in no case can he distribute his estate to the prejudice or injury of his creditors. They have the first claim to the property and must be first paid in all cases of doubt or uncertainty. Of course, if there is no doubt whatever concerning its solvency, the executor may proceed at once to pay the legacies, and to part with the real estate.

29. Having now treated in a general way of the duties of an administrator and executor, let us consider the duties of a technical trustee. Very often a person provides in his will that a specific sum of money shall be given to his children in trust. By this he intends that the property itself shall go into the possession of one or more persons as trustees who are to pay over the income to the persons designated, during a given period, or during their lives. Very often he leaves young children, and provides that all of his property given to them shall be kept in the possession and control of the trustee until they respectively reach the age of twenty-one, at which time he shall deliver to each one his respective share. Meanwhile, the trustee is to pay to each of them, at perhaps stated periods — monthly, quarterly or

otherwise — the income accruing from the property.

30. Formerly trusts were much more complicated in form, and property was often tied up during the lives of several persons. The law in this country has rather frowned on such dispositions. By statute in many states the right to create trusts for long periods of time and for many lives has been abolished. Yet everywhere the right to create trusts exists, and they fulfil a most important function. In every state they are numerous, and are executed either by individuals, or by companies created for that purpose.

31. An executor may be a trustee. The two offices rarely conflict with each other. For example, a testator may also direct that his executor shall act as trustee for A, in addition to performing his duties as executor. Sooner or later the property he holds at first as executor is subsequently retained by him as trustee, and his duty as executor is ended.

32. A trustee should not be a minor. He should give a bond in order to secure his beneficiary, the same as an administrator or an executor. He should also file an inventory of the trust property for the benefit of all concerned.

33. A trust will not fail simply because there is no trustee, because the court is competent to appoint one should the trustee or trustees designated by the testator die or become incapable of acting. Sometimes the court will appoint a temporary trustee, though this is unusual.

34. Sometimes a person intermeddles with trust

property without legal right. He is called a trustee in his own wrong, and is liable for so doing.

35. The duties of a trustee are varied. The testator rarely prescribes only the most general terms for his guidance — to preserve the estate committed to his charge, and to pay over the income and principal in the manner directed. But he has obvious duties to perform while the property is in his custody and control.

36. In executing these he may render himself liable for negligence in many ways.

(*a*) For example, it is his duty to have the trust property properly assessed, just as other individuals must have theirs; and should he neglect to perform this duty he would be personally liable for the penalty visited on transgressors. He could not, after paying the penalty, add the sum as a charge to the estate.

(*b*) He is also liable for the negligent use of the property. If it consists of a house it is his duty to keep it in proper repair, and should a person be injured by snow from the roof, or from his negligence to repair the sidewalk, or from the negligent overflow of water, he would be liable personally for the consequences, just as an individual under similar circumstances.

(*c*) The law prescribes rigidly that a trustee cannot use the estate for his own personal benefit. In no case can he sell it to himself. The law jealously guards against this temptation by declaring that all attempts to transfer it to himself as owner are futile and illegal.

(*d*) For the same reason he cannot pledge the trust

estate as security for his own debt. He cannot speculate with the funds committed to him, however honest may be his intention. He should not deposit them in a bank to his own personal credit, though this is often done, whereby they become mixed and lost to the beneficiaries.

37. Sometimes a trustee fails and makes an assignment; this does not include the trust property. It remains as before, distinct from his own, and cannot be taken for his own individual indebtedness.

38. The trust property may be taken for any indebtedness growing out of the execution of the trust within its legitimate scope. Of course, the trust-maker may limit in various ways the execution of the trust, and these limitations may be so effective in the way of notice to creditors as to cut them off from recovering anything made on contract with the trustee in plain violation of his authority. Unless limitations are thus imposed, a trustee may make lawful contracts pertaining to the execution of the trust, and subject the estate or income within his dominion for payment.

In like manner a mechanic's lien cannot be laid on a trust estate, except in those cases wherein the trustee has power to contract for the labour or the materials furnished. The trust itself usually is a proper guide to all contractors or creditors, and they must govern themselves accordingly.

39. On the death of one of several trustees, both the office and the title to the estate vests by survivorship in his co-trustee; when a sole trustee dies, either by statute or by common law the property vests in

his successor in trust, and in that manner the trust continues as before.

40. The general powers incidental to the office comprise those that are necessary for performing his duties, the power to administer, receive, and sue for the trust property, or any income accruing thereto, to invest the funds and lease the real estate, to keep it repaired and insured, to disburse and distribute the property, to protect the beneficiary, or maintain him if incapable of maintaining himself.

41. Authority to sell the trust property, and convert real into personal estate and vice versa, are usually bestowed on a trustee by a legislature or court. It is special, and not general, and incidental to that office, since the original conception of a trustee was a person entrusted with the title to the property, and not a business manager.

42. The execution by two or more trustees of their power is joint, and the execution even by a majority is void, unless the will or other instrument creating the trust authorises such action. Consequently the insanity or refusal of one trustee to serve may block all action; and the only remedy is the removal of one or more and the appointment of others in their place. This is a delicate function for the court to perform, and will not be undertaken unless the conduct of a trustee is factious, unreasonable, or corrupt.

It is true that in many cases one or two or more may do many things that will bind all. Thus, one trustee may collect dividends, rents, interest or any income, receive a simple debt or discharge a mortgage, but he

cannot assign or sell a mortgage, collect a judgment, or bind all by a compromise.

43. The power of a trustee is personal and cannot be delegated, either to a stranger, or by one trustee to another. It is the very essence of trusteeship that the person appointed shall act.

It is also true that many matters may be confided by a trustee to another who merely acts as the instrument or agent of the trustee himself. Thus, a trustee, who employs another to collect rents, is regarded by the law as collecting the rents himself. The distinction, although narrow, is pretty clear between the cases in which a person is employed as an instrument of the trustee in carrying out his direction, and the cases in which the employee is exercising a discretionary power himself. A trustee might very properly employ a lawyer to make out a conveyance of trust property; it would be quite another thing to ask the attorney to sell the property; for the latter act is solely within the boundaries of the trustee's power and cannot be confided to another.

44. Another important matter is the power of sale committed to a trustee. In many states the statutes prescribe the authority of trustees in this regard.

(*a*) Let us consider the subject of real estate first. Not infrequently it is desirable to sell in the interest of his beneficiary. In most cases the trustee cannot do this on his sole judgment; and must apply to the proper court for authority to sell. It may be that, by virtue of the power creating him a trustee, he can sell the real estate and invest the proceeds in other property;

more often than otherwise he must act through the intervention of the proper legal tribunal.

(*b*) It is his duty, so long as he is in possession, to lease the property and on the best terms obtainable. He has a wide latitude in making terms with a lessee. It is sometimes said that he cannot make a lease beyond the period of twenty years; in many states no limitation of time exists.

(*c*) He must keep the property insured and in adequate repair; in short, must exercise his authority for the best interests of the beneficiary. Should he neglect to improve it properly, or prevent its deterioration, or fail to lease it without good reason, such negligence would be just cause for complaint, and ultimately for his removal. For it must be remembered that the creator of the trust has always in mind the welfare of the beneficiary, and expects that the trustee will fulfil his duty efficiently and honestly.

(*d*) A somewhat different rule applies to the management of personal property. Besides attending to its safety, he must obtain, if practicable, a proper income therefrom. If, therefore, the property is invested in bonds bearing a very low rate of interest, and other bonds can be obtained, quite as safe and bearing a higher rate, it would be the trustee's duty to make an exchange, in order to enhance the beneficiary's income.

(*e*) The statutes in many states describe the kind of securities in which a trustee may invest; these release him from a serious burden, because, so long as his investments are within the prescribed limits, no one can justly complain.

(*f*) In selling personal property he has a wider latitude of acting without the intervention of the court, but in some of the states he is also required to make application as in the case of the sale of real estate.

(*g*) After selling the property he must put the money safely in bank and seek to secure an income therefrom while awaiting reinvestment. A trustee would not be justified in keeping the money thus derived from the sale of trust property long in idleness unless an extraordinary condition of things existed. One can imagine that, during a declining market, a trustee might hesitate to invest until he felt assured that the bottom had been reached; but, ordinarily, he must use all proper diligence consistent with safety to obtain a reasonable income from the trust property.

45. A trustee has no power to pledge or mortgage the trust property, even though he has authority to sell and dispose of it. This rule is disputed by some authorities, who maintain that the greater power includes the lesser; yet this is not the better rule.

46. A trustee has authority to bring and to defend suits for the protection of trust property. To that end he can employ counsel and incur all necessary expenses needful to preserve the trust fund.

47. It is the duty of a trustee to maintain and support his beneficiary. How far he can go in this direction often depends on the instrument creating the trust. Not infrequently this declares that only the income shall be paid to the beneficiary; in such a case the duty of the trustee is clearly limited. In

other cases he has authority to go further and to sell, if need be, the trust property or a portion, from time to time, and devote the avails in the same manner.

48. If he would neglect or decline to carry out the provisions of the trust, in accordance with the maker's intentions, this would be good cause for removing him from office. To a large degree his duty is discretionary, and when this exists a court will not interfere, save in a clear case of failure on his part to exercise his discretion reasonably.

49. In some states he is entitled to no compensation for his services; in most of them he may be reasonably paid. The amount is measured by the difficulty and responsibility of the service.

CHAPTER X

CORPORATIONS

§ 1. Stockholders

1. Who can form a corporation.
2. Can another corporation become a stockholder?
3. Consideration for shareholder's contract.
4. Right of withdrawal.
5. Agreement to subscribe for shares in a future corporation.
6. When contract becomes binding.
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33. Corporation includes all.

1. WHO can form a corporation? Generally it may be composed of all persons who are able to act in their individual capacity. Once it was questioned whether a married woman could be a subscriber for shares, because of her incapacity to make a contract; even now, in forming a national bank, the usual practice is, whenever she wishes to become a stockholder to act through some friend, or her husband, if she has sufficient confidence in him. After completing the organisation then the shares are transferred to her name and thereafter she becomes liable like any other stockholder.

For the same reason a guardian can hardly act as an original subscriber for shares because of his disability or incapacity to act either for himself or for his ward in some matters in the early stages of organising.

2. A more important question has arisen concerning the rights of other corporations to become original subscribers. This is largely regulated by statute. A national bank is forbidden from becoming a subscriber to the stock of any bank or corporation, and the same rule applies to many other corporate associations. On the other hand, modern business has so changed that it is often desirable for corporations to become original subscribers.

3. A question once existed concerning the consideration for the contract of subscription. The modern doctrine is that a person is bound by his subscription because the statute makes the obligation imperative.

4. Whether a person can withdraw before the subscriptions are complete is still perhaps an open

question. The more general view is, he has a right to withdraw until the subscription is rendered complete by enough subscribing to fulfil the law. When this is done then all are bound by the undertaking.[1]

5. Whether an agreement to subscribe for shares in a future corporation is equally binding is another question. In that case there is no offer which a corporation can accept, and the parties do not become stockholders and cannot be thus charged unless they subsequently carry out their agreement by subscribing for the shares. An offer to become a stockholder in a future corporation may undoubtedly be revoked at any time before acceptance.

6. An offer or contract to become a shareholder does not become binding until all conditions on which the offer or contract was made have been performed. No liability is incurred unless the corporation finally organised is the one contemplated at the time of the agreement.

7. Unless the statute prescribes otherwise, the contract of membership may be formed by a voluntary association of the members. Their intention to assume such relationship to each other is the only essential thing. Thus, the intention of individuals, to whom a charter has been granted unconditionally, to form themselves into a corporation may be shown by the simple acceptance of the charter. The same rule applies to an amended charter or subscription; no special form is required to give validity to the intention of the parties unless the law requires this to be

[1] See Vol. II., § 13, p. 423.

done. Generally, the corporation laws and charter describe in detail the methods of forming corporations, and of course these must then be pursued.

8. A statutory subscription for shares is something more than a mere offer to take and pay for them.

(*a*) It is like the liability of a banker to contribute his share of capital fixed by the articles of agreement. The contract of the shareholders is not mutual like that between the members of an unincorporated association. The contract is complete as soon as all the preceding conditions prescribed by law have been fulfilled. The stockholders then become entitled to all the rights and privileges; may vote at corporate meetings; claim a share in the profits of their common venture; become liable for all the obligations of stockholders; and must contribute the capital subscribed by them to the enterprise.

(*b*) The contract between statutory subscribers depends for its validity on the statute under which it is formed, and not merely on the common law. The intention of the legislature therefore in providing for the opening of stock books is to make a subscription binding from the time it was made. Otherwise the greatest facility would be given for practising frauds on innocent subscribers by means of subscriptions intended merely as a decoy. A subscription for shares made after the organisation of the corporation does not become binding until it has been accepted by the company through its proper agents.

9. Sometimes fictitious subscriptions are made to induce other persons to subscribe. There is a secret

understanding perhaps that no liability shall attach to the subscribers or that they shall be allowed to withdraw whenever they please. On the discovery of the fraud the subscriber who has been defrauded can do one of several things. If he has paid his money he can bring an action to recover it. If he has not paid, and is sued for the amount, he can repudiate the contract, and set up the fraud as a defence. He still has a third remedy — to accept his stock and sue for the damages sustained by the deceit that has been practised upon him.

Should the company become insolvent he is thereby prevented from rescinding his contract and recovering fully for the injury he has sustained. In such a case he may pursue the agent or party who by his fraudulent representation induced him to subscribe for the stock. A few years since there was a noteworthy case in Scotland in which the directors were held guilty for thus persuading persons to subscribe, and were made to pay heavily for the consequences of their misdeed.

When persons have thus subscribed who are not in one sense genuine or true subscribers, the bona fide ones cannot use these facts to release them for their own subscriptions. In other words, the existence of a fictitious subscriber in a body of stockholders does not, on the discovery of the fact release the bona fide ones from their undertaking.

10. Sometimes shares in excess of the amount allowed by the charter are subscribed after the formation of the corporation. The subscriptions taken

beyond the full amount are void and the subscribers are not members of the corporation. Sometimes the law provides for the allotment of shares among all the subscribers when the amount is not sufficient to supply all the subscribers. In such a case the contract between the subscribers remains incomplete until after making the allotment.

11. A subscription may be made to depend on performing preceding conditions. A subscriber does not then become a shareholder until the conditions have been performed. Until then he does not become entitled to the privileges, nor subject to the liabilities attaching to the status of a shareholder.

12. Subscriptions that are conditional on the happening of a future event must not be confounded with subscriptions made subject to special terms. In the former case the subscribers do not become stockholders until the prescribed condition has been fulfilled. In the other case after the event has happened they become shareholders on the same terms as other members.

13. The issuing of a share certificate is not an essential condition of ownership. It is merely evidence of ownership, and may be demanded by virtue of one's right of membership.

14. The issue of new shares by a corporation may be by ordinary subscription or by sale. (*a*) There is an important difference between the two methods. A person who agrees to purchase shares intends to buy the certificates as salable securities. Delivery of them, therefore, and payment are intended to be concurrent

acts, and on the failure to carry out the contract neither party can charge the other, without averring a tender of performance. On the other hand, the effect of an original subscription is to make the subscriber a shareholder at once, with a right to vote at meetings and liability to share in deficiencies and for assessments. The delivery of a certificate of shares is never a condition precedent to the liability of a shareholder for a contribution after a proper call has been made.

(*b*) Whenever the capital stock of a company is increased under a power conferred by its charter, each stockholder has a right to a proportionate number of the new shares before they can be offered or issued to strangers. Unless he waives this right, he may maintain an action against the company, should it deprive him of them, for the loss he has sustained. The measure of damages is an excess of the current value of stock above the par value at the time of payment of the last installment with interest on the excess.

15. Preferred stock is sometimes issued, and is so called because the owners possess more rights than other stockholders. Generally, preferred stockholders have a right to receive dividends from the earnings of the company before the holders of the common stock can share in them.

(*a*) Usually, such stock is issued to raise money for corporate purposes instead of borrowing on bond and mortgage.

(*b*) A preferred stockholder in some respects is

like the others, only he is entitled to a preference over them in distributing the profits. Such dividends are payable only out of the net earnings. Even a guaranty of dividends on preferred stock is not an absolute obligation; only a promise to pay the dividends that are earned.

(*c*) The owners of preferred stock generally, though not always, have the right to vote at any meeting of the holders of the capital stock. In issuing certificates to them it is stipulated whether they have the right to vote or not.

(*d*) Preferred stock may be so issued as to make the transaction strictly a borrowing; and the stockholders creditors. They are not liable for the debts of the corporation.

16. Whether a contract with a corporation is to purchase shares, or to become a present member, depends on the intention of the parties. When the payment of the price and delivery of the certificates are intended to be concurrent acts, the transaction will be a purchase and sale; when the contracting party is to have the rights of a shareholder before the whole amount of shares has been paid, the contract is one of membership.

17. A contract of membership like any other cannot be created without the mutual consent of the parties. Consequently were a person's name put on the subscription books without his authority, the subscription would not bind him. Nor does a person who subscribed through a pretended agent, who did not possess proper authority, become a shareholder.

The unauthorised subscriber can subject the subscriber to an action for damages.

18. Again, an alteration in the articles or an attempt to transfer the subscriptions to a new company will release a subscriber unless he has consented to the change by some word or act indicating his acquiescence.

19. The power conferred on a board of directors of allotting shares to applicants cannot be delegated to a committee composed of a part of their number. No valid allotment therefore can be made except by the board.

20. An irregular subscription made before the complete corporation may be treated as an open offer and accepted by the corporation after the organisation has become complete.

21. The directors usually have authority to dispose of unsubscribed shares. Whether they are bound to observe the same conditions as limit the powers of commissioners before organising in receiving subscriptions depends on the charter or statute. The general rule is they are not thus limited unless the contrary appears.

22. The authority of agents or commissioners to receive subscriptions is strictly limited to the duties they are required to perform. They cannot refuse to receive a subscription made by a competent person, nor release a subscriber, nor accept subscriptions on special conditions. A person who acts as agent for another without authority may have the defect cured generally by subsequent ratification.

23. A failure to comply with the forms prescribed by law in entering into a contract of membership does not prevent a person from becoming a de facto shareholder. The authority of original agents to receive subscriptions is undoubtedly limited by prescribed conditions, and an irregular contract would be contrary to law. This want of authority may be cured by a later act of incorporation. The mutual relationship existing between shareholders and the equitable rights of creditors must be considered.

24. A subscription for shares is a contract in writing and cannot be proved by parol evidence unless the original subscription paper is lost and proof of this has been given. Furthermore, the terms of the contract cannot be varied by parol evidence of a special agreement made prior to, or at the same time with the subscriptions.

25. A contract is not rendered voidable unless it represents facts which the defrauded party was under no obligation to learn for himself.

(*a*) A person who makes a contract must, at his peril, inform himself concerning the legal consequences of the undertaking. A simple misunderstanding about its legal effect is not sufficient ground for avoiding it. If this were not the rule mutual dealings would be impossible. A subscriber for shares must ascertain the contents of the subscription paper which he signs, the provisions of the charter of the company, and the general laws that affect it. A fraudulent representation, therefore, relating to these matters, or to the rules and duties regulating their membership in a

company, does not give the subscriber the right to avoid his contract.

(*b*) A fraudulent representation about the actual contents of a subscription paper or articles of association, without negligence on the subscriber's part, may be a good ground for avoiding the contract. Thus, a person who was unable to read and did not know the contents of the paper and who was induced to become a shareholder by a false representation concerning its contents, was relieved.

A contract is voidable for a fraudulent representation of facts, but not for a breach of agreement by either of the contracting parties. Therefore a failure on the part of a corporation to comply with the special terms of a subscriber does not render the contract voidable, but is merely a cause for action against the company.

(*c*) Subscriptions obtained by an agent by means of false and fraudulent statements concerning the happening of a future event, or the doing of a future act, cannot as a rule be avoided. Thus, a statement made by an agent that a proposed railroad would be built on a certain route within a fixed period of time would not render a subscription secured on the faith of it voidable, though he intended to deceive, and in truth does deceive, whenever the road is not built as promised.

(*d*) Whether a shareholder's contract be voidable for false representation must necessarily depend on all the facts that surround the transaction. Morawetz says, as a general rule any fraudulent representation

with regard to the financial state of a company or its arrangements for carrying out its enterprise, or with regard to any other fact which can reasonably be supposed to have been material in inducing a person to become a shareholder will enable the latter to avoid his contract. If a person is induced to take shares by false representation that another person has become a shareholder, or that certain persons have agreed to act as directors of the company, this will be a ground for avoiding the subscription, but it must appear in such case that a subscriber relied upon the statement and was induced thereby to take the shares.

(*e*) A person who has been induced by fraudulent statements to become a subscriber must proceed quickly to annul his contract, provided he desires or intends not to be bound thereby. On one of these occasions Lord Romilly said that a man must not play fast and loose. He must not say, "I will abide by a company if successful, and I will leave a company if it fails"; therefore, it is the subscriber's duty to determine at once whether he will depart from the company or remain a member.

26. Sometimes shares are cancelled. A certificate of shares is merely evidence of the shareholder's ownership, and consequently its cancellation does not relieve him from membership in the company. On the other hand, a certificate issued illegally or to a wrong person does not make him a holder, and its cancellation would merely destroy an invalid instrument.

27. The purchase by a company of its own shares is in effect to withdraw them and reduce its assets. This cannot be done unless the law specially provides for such action. Every continuing shareholder is injured by a reduction of the fund, and the creditors who have trusted on the consideration of the capital originally supplied have a reason for complaining. A reduction therefore, whatever form it may take, must be done in an open manner as the law prescribes. But if a company (having no indebtedness at a given time) should thereafter reduce its capital and then contract a new indebtedness, it would furnish no ground for complaint on the part of the creditors, unless, perchance, the reduction of the capital was done in such a secret manner as to operate practically as a fraud on them.

28. At common law a corporation has no lien on its stock for the owner's indebtedness, but in many states a lien has been imposed by specific statute or charter. And wherever the right exists the lien is not destroyed by violating the law restricting the amount that may be loaned to a borrower, except for the excess. In no case can the lien operate retrospectively.

Once, a corporation could establish a lien by usage; or by by-law under the general authority given to a corporation to regulate the mode of transferring its stock. While in some states this is still the law, the current of judicial decision is running so strongly against secret liens that the right to fasten a lien on stock by by-law is denied unless the authority is

clearly conferred by statute. This tendency is doubtless strengthened by the federal prohibition against the creation by a national bank of any lien on its stock. But a bank is not prevented from retaining a dividend that has been declared to lessen or discharge the indebtedness of the owner to the bank; for the money thus due to him is like any other free money he may have in the bank's possession.

Again, the directors of a corporation may receive its shares in the way of gift, bequest or payment in satisfaction of its debts. The law seeks to guard every company against losses by its debtors, and to this end provides that a company may take its own stock to avoid a loss. It is true that to this extent the fund that may be used for paying creditors is lessened. To obviate all danger of loss to them the law usually provides that the stock thus taken must be sold again within a stated period in order to preserve the amount of the company's capital. More properly speaking, the shares thus received are extinguished and new ones are created to fill their place. By a fiction, says Morawetz, these new shares are considered as if in all respects they were the old shares, and the corporation merely an immediate transferrer, but it would be an absurdity to say that a corporation can really hold shares in itself.

29. The members of the corporation may be compelled to pay for their shares by an action brought in the company's name. But it has no lien on them to secure the payment of assessments unless its authority is conferred by statute. Nor can the shares be

forfeited and sold for the non-payment of assessments except by express authority.

30. A shareholder on whom calls have been made cannot defend by saying that the agents of the company have exceeded their authority and done unauthorised acts. Their failure to manage its business in a legal manner is no defence in an action against him for not paying his share of the capital. In like manner directors cannot release some of the shareholders and cancel their shares. Acting without authority, the release would not bind the company, and would be wholly void.

Furthermore, a delay in completing the works of the company or in prosecuting its business will not discharge a stockholder from his obligation. Creditors are entitled to all the capital subscribers have paid, or have promised to pay, and ordinarily there is no escape from this obligation.

31. Some charters provide that the shares of stockholders may be declared forfeited and sold for the non-payment of assessments. This power must be construed strictly. A valid forfeiture can take place only by acting in a strictly legal manner. If the law prescribes a notice to be given to delinquent shareholders before forfeiture of their shares, this must be literally executed. If a sale by public auction is required a private sale would be void. Moreover, a sale for the non-payment of assessments would be void if this were unauthorised.

A grant of a power to declare a forfeiture does not exclude the common law remedy against the delin-

quent shareholder. The agents of the company may therefore proceed, either to collect the unpaid calls, or by way of forfeiture and sale of the delinquent member's shares.

A shareholder's liability ceases after the forfeiture is complete and his connection with the company is severed. A charter that provides for the sale of the shares of a delinquent member presumes that he would retain his membership until the disposition of them, consequently his liability would continue until that time and he would have a corresponding right to redeem them.

He may therefore satisfy calls on his shares and prevent a forfeiture at any time before the proceedings are complete, and he has ceased to be a member. But after the sale has taken place it is impossible to reinstate an owner and no right of redemption exists.

32. Lastly, the liability of shareholders is determined by charter or statute. The shareholders of national banks may be liable to creditors for an amount equal to the par value of their stock. For example, if a bank possessing a capital of $1,000,000 should fail, owing depositors $1,000,000, and the assets or funds remaining should amount to only 50 per cent. of this sum, the shareholders would be obliged to contribute $500,000 more to pay the creditors. One reason why corporations are formed is to limit the liabilities of shareholders; for, if they acted as partners, then each would be liable for all the debts of the concern. In a general sense, all the shareholders are partners, interested in the common business, sharing its profit

and losses, but with a limited liability. Every shareholder knows in the beginning that he cannot be rendered liable above the amount prescribed by law. This is one of the chief reasons for the rapid growth of corporate business institutions.

33. A corporation consists of the whole number of its members. It cannot, therefore, carry on business without the aid of agents, for the unanimous action of the stockholders would otherwise be essential to every act. There is an implied condition, therefore, in forming a corporation that the majority of members present at a shareholder's meeting shall have authority to bind the whole association by their vote. The powers of the majority are increased by charter or statute. Says Judge Lindsay: each and every shareholder contracts that the will of the majority shall govern in all matters coming within the limit of the corporation.

§ 2. Kinds and Authority of Corporations

1. Kinds of corporations.
2. Corporation sole:
   - *a.*— Described,
   - *b.*— Why an individual thus styles himself,
   - *c.*— An individual may become sole owner,
   - *d.*— He may be liable as a corporation for its debts.
3. Corporations aggregate, and how they are classified.
4. Foreign corporations.

5. Ways of creating corporations; how a legislative charter is obtained.
6. Creation of a corporation by complying with the requirements of a general law.
7. Duration of a corporation.
8. It lives through successors and not heirs.
9. Authority of a corporation is granted and continued by the state.
10. Its use of a seal.
11. Authority or privilege conferred on it is called a franchise.
12. Every corporation must have a name.
13. Corporation can sue and be sued.
14. Corporation can hold real estate.
15. Annual meeting.
16. Hour and place of meeting.
17. Power of majority.
18. Ratification of action of majority by all.
19. Meeting must be called in proper manner.
20. Remedy when officers refuse to call it.
21. Distinction between mode of calling regular and special meetings.
22. Adjournment of authorised meeting.
23. Members may adopt by-laws.
24. What by-laws can be adopted.
25. Every by-law must be reasonable.
26. Banking by-laws.
27. By-laws relating to savings-bank deposits.
28. Railroad by-laws.
29. By-law prescribing a lien on stock for debts.
30. By-laws do not affect non-members.

31. Shareholder only can vote.
32. Holder of record is the only rule.
33. Restriction on voting power.
34. Right of trustee to vote.
35. Joint owners.
36. Illegal votes.
37. When they will not be thrown away.
38. Voting by proxy.
39. Corporation cannot vote its own shares.
40. Appointment of inspector of election.
41. Corporation can do business in another state.
42. Opinion of United States Supreme Court.
43. Can do whatever is not prohibited, or contrary to state policy.
44. Rules of comity have the force of legal obligation.
45. Tax or license may be imposed.
46. Regulation of business of foreign corporation.
47. Suits.
48. Directors' meetings outside the state.

1. There are many kinds of corporations. The term *quasi* is applied to some of them, by which is meant associations or institutions that resemble corporations in some ways, but not in all. The supervisors of a county, the trustees of public schools and similar officers, are clothed with well-defined power. For example, the supervisors of a county can own and manage real estate for its use. These bodies can sue and be sued like other corporations, and are therefore thus regarded.

2. Another kind of corporation, called sole, is formed by a single person, a king or a queen.

(*a*) Such corporations are not very frequent in the United States, yet exist to some extent, especially in the church. A bishop is sometimes invested with the title and keeping of property given for church purposes, and is a corporation of this character.

(*b*) Although a single individual cannot form a corporation, not infrequently an individual, especially when engaged in banking, has styled himself a bank. Of course, his object is apparent — to gain the confidence of those who would not do business with him if they knew that he was acting solely for himself, without partners.

(*c*) The same rule does not apply to a person who purchases all the stock of a fully formed corporation. The corporation still survives. Thus, were a banker taxed by a state lower than a bank, the sole owner of a bank could hardly escape paying the higher rate on the ground that, after all, the corporation was not a bank but a banker. The law would say to him very plainly: So long as you preserve or continue this corporation it is thus recognised by the law, and you must pay the tax accordingly. The law regards the corporation as in abeyance awaiting a resurrection or restoration which may come at any time by the will of the owner.

(*d*) Though a person acquires sole control, he is liable in a corporate manner for the debts of the concern. This question was decided not long ago in Kentucky. By preserving the entity of the cor-

poration, on its failure he was required to pay its debts in the same way and to the same extent as if the corporation itself in every sense of the word had failed.

3. Most of the corporations in this country are called corporations aggregate, and are divided into several classes. First, religious corporations that are organised for religious purposes. Secondly, corporations embracing all that are not religious, and are divided into eleemosynary or charitable and civil. Illustrations of eleemosynary or charitable corporations are religious academies, hospitals, and the like. Civil corporations are again divided into two classes — public and private. Public corporations are formed for governing, of which cities and towns are examples. They are often called municipal corporations, and are created by the legislature of the states wherein they exist. They possess no natural or original authority; only such as are given to them by positive law or legislation. Some have contended that a town is an original form of government, possessing all the inherent authority not taken away by the state or the federal government.[1] Though town governments in New England states are much older than city or county governments, yet they derive, like them, all their life and authority from a legislative source. Lastly, private corporations may be mentioned, which are founded for private purposes and are

[1] "Associations and government institutions possessing only a portion of the attributes which distinguish ordinary private or public corporations have sometimes been denominated *quasi* corporations. Towns and other political divisions, school districts, boards of commissioners, overseers, or trustees of the poor, etc., having authority to act and bring suit as united bodies without regard to their membership for the time being are *quasi* corporations of a public character." 1 Morawetz on Private Corp., § 6, p. 6 (Second Edition).

the most common. Insurance companies, railroads, banks and the like, are private corporations.[1] To some extent they are public corporations, because they derive their authority from a public source, and because the legislature may make regulations concerning them. A railroad corporation, though classed as a private corporation, may be taken by the state, after payment, because it is created by the state and possesses a public character. If it did not it would have no authority to take and use the land of individuals for the purpose of building its road. Besides, the state can, if such a policy be deemed expedient, regulate the rates for carrying passengers and freight. This could not be done if it were strictly private, like a man who might carry freight and passengers either alone or in company with other persons.

4. Lastly may be mentioned foreign corporations, actors outside the state of their creation. An insurance company created by the state of New York, but transacting business in Illinois, is regarded by the latter state as a foreign corporation.

5. Corporations are created in two ways: by general law and by a charter.[2] The oldest way or method of creating a corporation is by legislative action. The persons who desire to form a corporation give notice before the next meeting of the legislature of their intention to apply to that body for the creation of a corporation. On assembling a petition is presented

[1] "Private corporations are associations formed by the voluntary agreement of their members. . . . Public corporations are not voluntary associations at all, and there is no contractual relation between the corporators who compose them." 1 Morawetz, § 3.

[2] In some states special charters are no longer granted by their legislatures.

through a member, setting forth this fact or wish, accompanied by a bill setting forth the powers which they desire to have conferred on them.

The petition is referred to an appropriate committee, a report thereon is made and discussed by the respective houses, and if the bill is considered favourably and signed by the governor, the associates are endowed with corporate power. Charters are monopolies, and in olden times especially were regarded as very valuable. Their creation gave rise to many abuses; furthermore, the method was too slow for the demands of modern business, and so another mode has been adopted for accomplishing this end more speedily and effectively.

6. This is by enacting general laws providing for the creation of corporations. In probably every state there is a law of this character, prescribing conditions on which corporations can be formed; and besides this general law, some states have also other laws providing especially for different kinds of corporations, like railroads, banks and insurance companies. These laws provide that application must first be made to officers who are named — the secretary of state, attorney-general, superintendent of banking, or other officer, or perhaps to several of them. The application is then examined, the associates give proper notice of their formation, pay in their capital, elect officers, and comply with every other legal requirement. When these things are done the corporation is born, endowed with real life. All corporations therefore created by general law of the same class or

kind possess similar powers; while those chartered by the legislature are often endowed with powers more varied and extensive.

7. A corporation is often regarded as a perpetual body; of late years a shorter term has been given to them. The national banks, for example, are chartered for a period of twenty years, and many of them have had their charters renewed, and are living during the second, or even third, period of their existence. A corporation never dies in the same sense that death overtakes an individual. Its members die, others take their places. A corporation may be likened to a river — ever changing, yet ever flowing.

8. A corporation has no heirs or inheritors like an individual; it continues through succession, one member succeeds another, like the leaves on a tree; in this way its life is preserved.

9. The authority of a corporation depends on the will of the legislature; it is a creation of the state. It has such powers as are expressed in its charter or by general law, with such incidental powers as are needful for the effective execution of these specially granted. Formerly, a corporation could not hold property for the use of another, it could not be a trustee; now, a corporation can transact such business if the authority has been properly conferred. In many of the states they often act as executors and administrators of estates.

10. A corporation has a seal; a partnership has none. Once it was said that the seal must always be used in the transaction of its business; it could not

express an intention by any personal act; it had no soul, it could not speak, but only make an impression. This view of a corporation was found to be too limited; its business became too extended to be transacted in this slow manner; consequently, it was long ago declared that a corporation could make verbal contracts through its executive officers in the same manner as a partnership. How badly fettered would a railroad be if obliged to affix a corporate seal to every freight contract made by its agents. Very many things therefore may be done to which a corporate seal need not be added to make them legal.

11. The authority or privilege conferred on a corporation is called a franchise. *Quasi* corporations have no privileges or franchises. This is one of the marks that distinguish them from other corporations.

12. Every corporation must have a name by which it is known. Corporations in the same state should not have a similar name; nor would one be intentionally granted to a second corporation.

13. Corporations can sue and be sued in the same manner as individuals. This authority and liability is prescribed by statute, and is important to their life and power. If a corporation could not sue it would be crippled in transacting its business; on the other hand, if it could not be sued it would not be safe for others to do business with it. Its liability to sue and to be sued is very general, extending to contracts, negligence, and wrongs of all kinds.

14. A corporation can hold and sell real estate. Some limits have been put on corporations in this

regard. The national banking law prohibits a bank from holding more real estate than is necessary for banking purposes; it cannot even take real estate to secure a note that is discounted in the beginning, though it may do so afterward as additional security. If a complete title to such estate were acquired by proper legal proceedings it could not be held for a longer period than five years. The bank would be then obliged to sell, whatever might be the price obtainable. The reason for thus restricting corporations in the holding of real estate is to prevent them from getting possession of too much. There was a time in English history when corporations owned such a vast quantity of real estate that a restrictive law was passed which afterward was enforced in the American colonies. Modified from time to time, corporations can now hold whatever real estate may be necessary for effectively transacting their business. For example, a railroad company can buy land for its way, for stations and offices, but it cannot buy land for ordinary investment or for speculation.

15. Once a year an annual meeting is held by the shareholders for the election of directors, and other business. At this meeting the shareholders are either present and vote, or they are represented by others; very frequently they give an authority, called a proxy, to some other person to act for them. Not infrequently an annual meeting is held at which two or three persons act for a very large number of shareholders. Usually each share is entitled to a vote, but some charters provide that each shareholder has only

one vote notwithstanding the magnitude of his holdings.

16. The meeting must be held at a reasonable hour, and in a convenient place to the great body of shareholders. Generally the charter prescribes where the meeting must be held. It is said that there is no objection to holding a meeting in a foreign state, provided all the directors give their consent. Morawetz says that in the absence of an expressed statutory prohibition there appears to be no reason why the shareholders in an ordinary business corporation should not provide in their articles of association that meetings may be called at convenient places outside the state under whose laws the company is formed.[1]

17. The meeting is controlled by the majority. They comprise that portion of the stockholders who are present at the general meeting and entitled to control the corporation by their votes.

The majority need not be present at the meeting in order that the resolutions may be binding on the corporation. Unless there is an express statute to the contrary, the rule is that such of them as actually assemble at a properly convened meeting constitute a quorum for the transaction of business, and the majority of that quorum have the authority to represent the corporation.

The power of the majority to bind the whole body is derived from the agreement of the association. The majority, therefore, cannot represent the corporation in any transaction contrary to its chartered

[1] See § 47.

purpose, nor can they do anything without complying with every formality prescribed by charter, statute or custom.

The majority of the corporation can exercise no greater powers than the individual members of the company can bestow. The courts would undoubtedly scrutinise with strictness any acts of a majority who should seek to obtain an advantage at the expense or loss of the corporation as a whole. Should they attempt to appropriate the corporation's funds to their own use, or to depart from the company's charter or from the general law that governs corporations, the courts would interfere to protect a shareholder.

18. The action of the majority, even though unauthorised by the charter, may be ratified by the other shareholders. Very many informal acts are rendered valid by subsequent unanimous consent.

19. To enable the majority to act at a meeting this must be called in a proper manner. Every shareholder is entitled to be present and to have a proper notice thereof. The statutes and by-laws passed by the company prescribe how notices must be given. If a notice to anyone is omitted those present have no authority to act for the whole body, and the transactions at the meeting will not be binding as corporate acts. Says the highest tribunal of New York: it is not only a plain dictate of reason, but a rule of law that no power or function entrusted to a number of persons can be legally exercised without notice to all the members composing such a body.

If, however, the charter and by-laws of the company

fix the time and place at which regular meetings shall be held, this is a sufficient notice to all the shareholders, and no further notice need be given.

If the charter and by-laws contain no express provision for calling meetings, the managers have authority to do so when they deem meetings to be desirable. In most cases the laws provide in express terms what officers shall have authority to call meetings.

20. The officers who wrongfully refuse to call a meeting as they ought to do by law may be compelled to do their duty by the courts in a proceeding called a mandamus; in other words, the courts can compel the officers to call a meeting in obedience to the wishes and request of the stockholders.

21. A distinction has been made between regular and special meetings. The former are held in the manner prescribed in the charter and by-laws; the special ones are called at irregular times on proper authority. A notice for a special meeting must state particularly the object, and no business can be transacted except that stated in the notice.

The rule is otherwise concerning the notice of a regular meeting. Unless the business be of great importance, nothing need be said concerning it. Thus, a mutual fire insurance company held a meeting which was called for the purpose of making alterations in the by-laws, and transacting such other business as might come before the members. It was decided that the notice was not sufficiently specific to enable the majority of those present to increase the number of the directors.

22. An authorised meeting may be adjourned from time to time without giving further notice to the shareholders. This is simply a continuation of the original meeting. Says Judge Redfield: whether a meeting is continued without interruption for many days or be adjourned from day to day or from time to time, many days intervening, it is evident that it must be considered the same meeting without any loss or accumulation of powers.

23. The members may adopt reasonable by-laws regulating the manner of voting and holding meetings and directing the order of proceedings. Their validity depends on the implied agreement of all the shareholders in forming the corporation, and therefore any by-law properly enacted by the majority is as binding on the members of the company as those provided in the charter.

24. What by-laws a company may make must depend on the charter and general statutes, as well as public policy. Not every by-law made by a corporation is valid, only those that are reasonable and needful to carry into effect the objects of the corporation. Many of the by-laws regulate the manner of holding meetings, electing officers, transferring shares, and the like.

As the charter or general constitution, either alone or combined, is the fundamental law, it cannot be set aside by adopting contrary by-laws. Nor can the authority of a corporation created by charter or statute be enlarged by a by-law. For example, a by-law would not be valid authorising a corporation

to make a usurious contract. In one of the cases Justice Folger declared that "all by-laws must be reasonable and consistent with the general principles of the law of the land by which they are to be determined by the courts when a case is properly before them. A by-law may regulate or modify the constitution of a corporation, but cannot alter it. The alteration of a by-law is but the making of another upon the same matter. . . But a by-law that will disturb a vested right is not such."[1]

25. Clearly, every by-law must be reasonable in the way of affecting all interests. Thus, a by-law of a chamber of commerce, providing for the expulsion of a member who did not comply with a contract he had made with another member, was held valid. Clubs, benevolent societies, and other associations usually provide by-laws for trying and expelling their members who have valid obligations imposed upon them by virtue of their membership. Such by-laws have often been sustained, though it may be added that before a member can be expelled there must always be given him an opportunity to defend himself against the charges preferred against him.

By-laws that are vexatious or manifestly detrimental to the interests of the corporation are void. Thus, a majority have no authority to pass a by-law declaring that a member who fails to pay an assessment shall forfeit his share or a dividend until all arrears have been paid.

Again, a by-law requiring the members of a company

[1] Kent v. Quicksilver Mining Co., 78 N. Y., 182.

to submit their controversies to arbitration, otherwise they are to be expelled should they bring suit, is invalid.

26. Banking institutions are constantly adopting new by-laws as the occasion for them arises. This is especially true in regulating the payment of deposits. It is generally said that a depositor must have a notice of a by-law in order to be bound thereby; nevertheless, he may submit to a by-law prescribing that he shall be bound by any amendment that may be made to the by-laws, even without notice of it. This rule has been applied on several occasions. Though on the very verge of the law, it has judicial sanction.

27. Sometimes savings-bank depositors have contended that they were not bound because they could not read the by-laws. The courts have said that this was no excuse; that they ought to ask others to read the by-laws to them. In no case is a bank required to interpret a by-law to a depositor. In many cases there are several depositors in a bank having the same name, and it is quite impossible to identify every one of them. A very common rule among savings banks, that it deems itself justified in paying a deposit to a person who presents a book and claims to be the owner, unless there is some reason to suspect wrongdoing, will justify the institution in making payment. No rule will absolve a bank from negligence in this regard.

Again, a by-law of a savings bank prescribing the mode of investing savings-bank deposits is merely a

direction to the officers of the bank, conferring no rights whatever on the depositors.

28. Companies that are engaged in a public business, like a railroad, frequently adopt and publish rules for the goverment of those who transact business with them. These rules, though called by-laws, are obviously somewhat different from the by-laws passed by a corporation for its own management. By-laws of the latter kind are binding by virtue of the implied terms of the contract. By-laws of the former class are merely conditions binding all persons who choose to deal with the corporation. Thus, railroad companies provide rules for transporting travellers and goods and regulating the terms of service of their own employees. Persons dealing with them who know the rules and regulations thus published are held to assent thereto.

29. Lastly, a corporation cannot enforce a by-law giving a lien of the shares of its members for debts due the company as against the bona fide purchaser of certificates of the shares who had no notice of the by-laws.

While every member is bound by the by-laws adopted by the majority, a non-member is not bound nor can he claim any right by force of a by-law. The Supreme Court of Massachusetts has declared that the office of a by-law is to regulate the conduct and to define the duties of the members toward the corporation and between themselves. So far as its provisions are in the nature of a contract the parties thereto are the members of the association themselves. The

right of a third party, a stranger to the association, to establish a legal claim through such a by-law must depend on the general principles applicable to express contracts.

30. A person who deals with an agent of a corporation is not required to take notice of the company's by-laws, nor is knowledge of them presumed. Therefore a contract made in good faith with an agent of a corporation when the agent is acting within the scope of his apparent powers binds the corporation itself, although the agent acted in violation of the existing by-laws.

31. The right of vote belongs only to the shareholders. The assignees of shares that have been equitably assigned cannot vote on them until they have been formally transferred in the manner prescribed by the charter and by-laws of the company.

32. The vendor or seller of shares, therefore, and not the vendee, can vote on them until they have been transferred on the stock books. The same rule applies between an obligor and an obligee, a mortgagor and a mortgagee. A trustee, also a guardian, can vote, so long as he is legally serving in that manner. Likewise the corporation itself holding any shares can vote on them through an agent who is duly authorised for that purpose.

33. Of course, a person may restrict his right to vote in various ways; thus, a shareholder who has made a sale of his stock has in truth no right as against his assignee to vote on them without his consent, although the regular transfer may not have been executed on

the company's books. The rights, however, between the assignor and assignee are one thing, and the rights between a second party and the company are another.

34. The right of a trustee to vote on shares depends, it is said, on the terms of the trust. Usually, he has this authority.

35. Joint owners who disagree about voting can cast no votes.

36. To receive illegal votes will not necessarily vitiate the action of the majority. If there are enough votes to elect a director — for instance, after throwing out the illegal ones — his election is lawful; but a person who has received a minority of votes cannot be declared elected, because a sufficient number of votes in his favour to make up the majority was refused. The denial of jurisdiction in courts of equity to restrain persons from acting as officers under a void election does not proceed from the supposed incapacity of courts of equity to pass on a question of this kind. The reason is because the legal method is clear and effective. Therefore when the object is to declare the regularity of the election or to declare the office to which one has been elected forfeited, a court of the law is a competent and proper tribunal.

37. It has been held that votes cast for a candidate who is disqualified for the office will not be thrown away, making the election fall on a candidate having a minority of votes, unless the directors cast their votes with full knowledge of the fact and consequences.

38. Stockholders often vote by proxy, but the right

to do this must be expressly conferred by the company's charter or by-laws. The power of attorney to execute this authority need not be in any prescribed form nor executed with much formality. Says the Supreme Court of New Jersey: "A stockholder . . is undoubtedly bound to furnish his agent with such written evidence of the latter's right to act for him as will reasonably insure the inspectors that the agent is acting by the authority of his principal. But the power of attorney need not be in any prescribed form nor be executed with any peculiar formality. It is sufficient that it appear on its face to confer the requisite authority and that it be free from all reasonable grounds of suspicion of its genuineness." [1]

39. A corporation cannot vote on its own shares. It is only by a fiction that they can be regarded as existing. It would be an absurdity to allow the company to vote on them for the purpose of controlling or diminishing their voice in the management of their own property.

40. The right to appoint inspectors or judges of election is vested in the shareholders themselves. Neither the shareholders nor inspectors can inquire into the true ownership of the shares, or deprive a legal owner of his right to vote. Says Justice Depew, in an important opinion: "The general rule is that the books of a corporation are the evidence of the persons who are entitled to the rights and privileges of stockholders in the management of the affairs of the corporation, with the single exception that the stock

[1] In re St. Lawrence Steamboat Co., 44 N. J. Law, 534.

really belonging to the company cannot at any election for its directors be voted on directly or indirectly."[1]

41. A corporation has implied authority to carry on its legitimate business in foreign states, unless this is prohibited by its charter. Of course, no state can authorise a corporation to engage in business outside its own jurisdiction, because if it could there would be a clash in the conflict of jurisdiction leading to the gravest results. On the other hand, the principle of comity is given wide application in permitting corporations having a legal existence in the state of its origin to do business elsewhere.

The general principle may be thus stated. A corporation in Pennsylvania, engaged in banking, manufacturing, insurance or other business, is permitted to do anything pertaining to its business in the state of New York, for example, that any corporation of a similar character can do there, not opposed to the interests or policy of the citizens of that state. If the Pennsylvania corporation wishes to buy land in another state it must conform to the law of such state in its purchase and management, because the principle prevails everywhere with regard to land that the laws that apply thereto are those strictly of the place of location.

42. In the early federal case of the Bank of Augusta v. Earle,[2] the Supreme Court of the United States considered this subject. The court said that it was

[1] In re St. Lawrence Steamboat Co., 44 N. J. Law, 539.

[2] 13 Pet., 519, 585.

very true that a corporation can have no legal existence beyond the limits of the sovereignty by which it is created. "It must dwell in the place of its creation, and cannot migrate to another sovereignty. But, although it must live and have its being in that state only, yet it does not by any means follow that its existence there will not be recognised in other places, and its residence in one state creates no insuperable objection to its power of contracting in another."

43. A corporation therefore can by its agents go into another state and make any contract or conveyance within its chartered authority, provided it is not prohibited by the laws or policy of such state. Again, it may maintain an action to enforce its rights in another state or country unless such action is contrary to its laws, very much as the corporation can do in the state of its own creation.

44. The rules of comity have the force of legal obligation and it is the duty of the courts to respect them. Comity is a part of the common law.

45. As a state may entirely exclude a foreign corporation, it follows that it may impose a tax or license fee on a foreign corporation even if no tax is imposed on a similar corporation of its own creation. A foreign corporation may, therefore, in competing with a domestic corporation, be put at a disadvantage for which there is no remedy unless perhaps that of public retaliation.

46. Thus, a state may enact laws, and many of them have done so, regulating the mode of doing

business by foreign fire and life insurance companies. Some states require foreign corporations doing business within their territory to have an agent there who can be sued, instead of requiring a policy holder to go to the state where the company exists, in order to bring a suit on the policy, in the event of failure to obtain a proper settlement.

Again, some states require a foreign insurance company to have a fund within its territory, so that it may always be able to respond to the demands of claimants. Such regulations are not at all uncommon, nor do they infringe particularly on the general principle above noted.

47. A state cannot prevent a corporation from removing a suit into the federal courts; and a stipulation to that effect as a condition of its permission to do business would be void.

48. A board of directors may hold their meetings outside the state where their company is chartered, unless the by-laws or charter forbids such action.

§ 3. Directors and Managers

1. Directors are share holders.
2. Disqualified director has no authority.
3. They should possess business experience.
4. Their general authority.
5. How far it extends.
6. Directors can act only as a board.
7. Can ratify separately.
8. They cannot expel a director.

9. Are not technical trustees.
10. Must pay their company's debts, regardless of consequences.
11. Cannot fix their own compensation.
12. Cannot make a valid contract with themselves.
13. By the modern law their contract is voidable.
14. Majority can safely contract with one or more of their members.
15. Directors may contract with shareholders.
16. Imputation of director's knowledge to his company:
    a.— Reason for rule,
    b.— Difficulty in applying it,
    c.— When it is not imputed.
17. Action of same directors in two companies with opposing interests.
18. General liability of directors; minimum rule.
19. Maximum rule.
20. Are liable for false representations.
21. What must be shown to maintain action.
22. Directors may resign:
    a.— How this should be done,
    b.— Do not escape previous liability by resigning,
    c.— When they cannot resign.
23. Distinction between their business and ministerial duties.
24. Authority of general officers.
25. Extension of their authority.
26. A bank president.
27. Extension of authority is not uniform.

28. Gradual growth of authority.
29. Authority of vice-president.
30. Appointment and authority of agents.
31. Officer is as responsible to his company for wrong-doing as to a stranger.
32. Remedy.
33. Liability of officers to creditors and stockholders for wrong-doing.

1. A corporation is governed by the directors, who in turn are guided by its charter, the general statutes and the common law. The directors are always shareholders unless the company's charter contains a provision to the contrary. The National Banking Act requires that every director shall own at least ten shares of stock, and somewhat similar provisions exist in the laws regarding other corporations. But a director who becomes bankrupt does not thereby vacate his office.

2. The majority of a corporation cannot elect a person to the office of director who is ineligible by the terms of the charter, and a person who is not qualified to act as a director has no authority to represent the corporation.

3. The directors should be men of practical business judgment, and selected by reason of their fitness to manage the corporate affairs. It does not follow that the majority of the shareholders can control them, or interfere with their management. The authority of the board is derived from the unanimous agreement of the shareholders expressed in its charter, and hence

their power cannot be impaired by the majority. Says Morawetz: "The rule limiting the authority of the power of the majority to the general supervision of the affairs of the corporation is established for the protection of the individual shareholders, as well as for reasons of practical convenience. A board of directors selected by the shareholders are better adapted to carry on the business of the company successfully than the shareholders themselves assembled at a general meeting." [1]

4. The general authority of the board extends to the management of the regular business of the incorporation. Even an express provision that the powers shall be exercised by its board of directors does not deprive the majority of the shareholders from directing the general policy of the corporation, and of deciding on the propriety of important changes in the company's business. Says Morawetz: [2] "The board of directors has no implied authority to make a permanent change of the business or constitution of a corporation, even though the alterations be within the company's chartered powers. Such an alteration can be effected only by the shareholders at the general meeting. For the same reason the directors cannot wind up the company, or sell any property which is necessary to the company's business."

5. How far their authority extends depends on the company's charter and statute. No agent under any circumstances can act in violation of law. The

[1] § 511.
[2] § 239 (First Edition).

authority of the president and directors of many companies is largely determined by custom, and parties who deal with them are supposed to be familar with their authority.

Furthermore, directors have wide discretion in delegating their authority. How far they can go depends on their charter, by-laws and usage. In many corporations the tendency is for directors to circumscribe more and more their work and appoint others to assist them.

A very good illustration of this is furnished by the action of bank directors in delegating their authority to lend the bank's money to the president, the cashier or a committee. There was a time when this could not be done. The law was very strict in maintaining that this was the chief duty of the directors, and must actually be performed by them. By the modern law, except in a few states, they may delegate their entire authority, even in this most important matter, to a committee of their board or two or three officials of the bank.

Thus, the specific powers and duties of the directors are constantly narrowing. There are, however, some duties which they cannot delegate to others. For example, the making of the reports required by statute.

6. A director has no authority to act separately and independently of his fellow members. Only as a board, duly convened, is he a representative of the corporation.

If, therefore, each one should separately, outside

a board meeting, assent to an act it would not be a corporate act and binding on the company.

It is not necessary for them all to meet, and rarely do they all, especially the members of a large board, but notice of their meetings must be properly given, and the majority when assembled must act in the manner prescribed by the statute and by-laws.

7. While it is true that directors can act only as a board in performing their duties, they can singly ratify the action of their officers, and in this way a great many acts are legalised. On many occasions only a small number of the directors attend, and yet, generally speaking, all, with few exceptions, have a good knowledge of the most important affairs at least of their corporation. Their knowledge, by whatever method acquired, operates as an acquiescence in or ratification of what has been done. This principle of ratification plays an important part in the management or conduct of nearly all corporations.

8. It is a general law of agency that the powers of an agent may be revoked at any time by his principal. The rule does not apply to corporation directors. Says Morawetz: "The majority of the board clearly have no power to expel an individual director, or to exclude him from inspecting the company's books and participating in its management, although they may believe him to be hostile to the interests of the association."[1] Though they may have no authority to revoke the powers of any agent, like a president, or treasurer, whose term of office is fixed by the charter

[1] § 541.

or articles of association of the company, it does not follow that they have authority to remove an agent of this character merely because they appoint him pursuant to the provisions of the charter. There should be an express provision granting the power of removal.

9. The directors are not trustees in the technical sense, though they are often thus called. Yet the relation between the directors and the company is in many respects a trust relation. Whenever, therefore, an agent is invested with authority to use any discretion this must be exercised in good faith for the benefit of his principal.

10. It is their duty to pay the company's debts, and they are justified in using the corporate assets for this purpose, although the company be thereby disabled from carrying on its business, provided they act in good faith and with due regard to the interests of all the shareholders.

11. The directors of a corporation cannot fix their own compensation. They are entitled to none for their official services unless this is provided by charter or by-law, or by the shareholders. But a director who is employed to perform other services — an attorney, for example — can charge for this.

12. Directors have no right to bind the company by any contract made with themselves personally, or to represent it in transactions with a third party wherein they have a private interest. This is founded on the general principle of agency that an agent cannot act at the same time for both parties. Yet

this principle is constantly violated. Thus, on one occasion the shareholders of a company empowered the directors to obtain a loan of money for the purpose of carrying on the company's business. Instead of honestly executing the order the directors borrowed fifteen thousand dollars and used the larger portion in paying their own debts. The court held that this was an unauthorised transaction. Said Justice Davis: "Directors hold a place of trust and by accepting it are obliged to execute it with fidelity not for their own benefit but for the benefit of the stock-holders of the corporation."

Again and again it has been decided that a director cannot become the purchaser of property sold at public sale.

13. To this rule there is an important qualification. The transactions between directors and their companies are not necessarily void, but simply voidable. Many of them are made in perfectly good faith and for the best interests of the company. In making them the directors seek no undue or wrongful advantage. In every case of this kind the law declares that the company may set aside such transaction at any time before the statute of limitations has gone into effect. But corporate life now plays such an important part in the business of the world that it has become needful to modify the rule as above expressed.

14. Another principle has also come into operation within a comparatively recent period. A majority of the directors of a corporation may lawfully act as

opposed to the minority, and this rule rests on reasonable ground. For, so long as the majority of the directors are acting for the corporation, their action is in a true sense the act of the corporation itself. Thus, suppose a single director of a bank wished to borrow money and made a proper application therefor, and the remainder of the board should act favourably on his application. such action would be unquestionably legal, as clearly as if he were an outsider.

We may readily imagine a different state of affairs. Suppose a director should make an application on which all the others should act, by agreement, favourably. Clearly there would be in form two parties to the proceedings. Suppose each director in turn should make a similar application on which the others should act in the same manner. Though in form there would be two parties in each transaction, yet in reality there would be only one, as each loan would rest, after all, on the prior agreement or understanding. The law in such a case would look at the real agreement or conspiracy among the directors, and not at the form or shell in which they might express their action.

15. Directors and shareholders may deal with each other as freely as with strangers. There is no trust relation between directors and shareholders except in the management of the corporate interests.

16. The knowledge of a director or other officer of a company is said to be imputed to it under many conditions or circumstances. It is true that this rule is less effective than formerly, because it is somewhat artificial in its nature.

(*a*) Nevertheless, it is founded on a sound basis, that the knowledge of an agent is presumed in law to be the knowledge of his principal, who is affected thereby.

(*b*) The difficulty with the principle in practical operation is, the agent does not always communicate the knowledge; consequently the principal in fact does not always possess the same knowledge of the transaction as the agent himself. The tendency of the modern courts, therefore, which have a deepening regard for justice, is to narrow the operation of this great principle.

(*c*) Thus, in the conduct of a director there are many exceptions to the operation of this principle. It is said, for example, that if knowledge is acquired by him in the ordinary way it is often not to be imputed to his corporation for the reason that he is a business man more deeply interested in his own affairs; and that it is not quite fair to assume that he will charge his mind with the knowledge thus acquired and communicate it to his company. Suppose a director learns about some defect in a note, the ability of the payee or indorser, and that it is presented for discount at a meeting of his bank attended by himself. His knowledge of its imperfect character is not imputed to the bank for the reason that the law does not assume that he has retained the information accidentally acquired. So, too, knowledge that he may have acquired before becoming a director or in outside operations and ways are not chargeable to the bank. In short, to impute the knowledge acquired by him to the bank, he must

be specially charged with the duty of communicating it. If he should be told something and promise to make the information known to his associates, and forget or neglect to comply, then the bank or corporation would be regarded as having notice.

On one occasion it was remarked that "a notice to a bank director or trustee, or knowledge obtained by him while not engaged either officially or as an agent or attorney in the business of the bank, is inoperative as a notice to the bank." If this were not the law "corporations would incur the same liability for the unofficial acts of directors that partnerships do for the acts of partners; and corporate business would be subjected oftentimes to extraordinary confusion and hazards. Any director would have as much power as all the directors. A single trustee or director has no power to act for the institution that creates his office except in conjunction with others."

17. Persons who are appointed to act as directors of different companies have no authority to represent them in transactions wherein their interests are opposed. Nor does it matter whether the acts of the directors are in the interests of the majority of the shareholders of each company and have received their approval. Says an authority from whom we have already quoted, nothing can be more unjustifiable and dishonourable than an attempt on the part of those holding the majority of the shares of a corporation to place their nominee in control of the company and then to use their control for the purpose of obtaining advantages to themselves at the expense of the

minority. It would be a conspiracy to commit a breach of trust.

In one of the cases calling for the application of this principle two railroad companies, whose lines connected with a third company, bought a controlling interest in its stock and elected a number of their own agents directors. They proceeded at once to make contracts between this company and the other two which were injurious to the minority interest of the third company. The Supreme Court of New Hampshire, where this contention arose, held that the third company whose management had thus been changed had an absolute right to refuse to be bound by the transactions, whether the contract was fair or not.

This principle is far reaching and most salutary. The cases are constantly occurring in which the majority in interest take advantage of their position to wrong or injure the minority interests, and the courts need to be vigilant in thus guarding the interests of the minority against raids made by those who are in control.

18. The liability of directors is not so great as many suppose. Directors are advisers and not managers, and are not responsible for much that pertains to the management of their association. They are responsible for fraudulent conduct and for specific violations of positive law, but not for mistakes. Two rules apply to their acts of negligence: these we may call the minimum and maximum rules. By the minimum rule a director must exercise ordinary care and attention. Suppose a bank director should neglect to attend the usual board meetings, and the other directors should

make loans exceeding the amount prescribed by law, would the absenting member be guilty like the others? If he knew or suspected that they were violating the law, and intentionally remained away, by some tribunals he would be regarded guilty for not attending and attempting to restrain his co-directors, or, if failing in his good purpose, for not resigning. But, ordinarily, he is not required to attend, regularly, board meetings, and if he remained away, not knowing nor suspecting that his co-directors were violating the law he would not be responsible for their wrong-doings.

19. By the maximum rule directors must exercise the same degree of attention in conducting the business of their corporation that prudent men exercise in conducting their own affairs. In a recent case the court thus stated the rule: "It is necessary for them to give the business under their care such attention as an ordinarily discreet man would give to his own concerns under similar circumstances, and it is therefore incumbent upon them to devote so much of their time to their trust as is necessary to familiarise them with the business of the institution and to supervise and direct its operations."[1]

The minimum rule has the sanction of the highest federal tribunal, and also of the supreme courts of a few states; the maximum rule has the sanction of far more.[2]

20. Directors are responsible for false representations concerning the funds of their company whereby others are induced to give it credit or to purchase its obligations or shares. When they issue reports or a

[1] Warren v. Robinson, 19 Utah, 289, 303.

[2] See article by the writer in March No. of Yale Law Journal, 1903, for a full exposition of the law on this subject.

prospectus intended for general circulation and to advertise and give credit to the company with the public, they are responsible for the natural consequences of their action, and if the report or prospectus were false or fraudulently made, anyone who is misled thereby has an action against the directors. This principle has been applied on many occasions.

In one of these cases, which has often been cited, the directors were promotors of a mining company, and a purchaser, by their false statements, was led to believe that the company owned a large amount of property. Relying on them, he purchased shares in the company, which proved to be worthless. He had the satisfaction though of recovering from them his loss.

21. To maintain this action it must be shown that their representations were false and made wilfully. They are assumed to have general knowledge of the company's management and financial condition. Knowing that their position naturally leads the public to believe their statement, it is their duty not to abuse this belief by false or thoughtless statements. Yet they are not presumed to have notice of everything relating to the management and organisation of the company; only those things which would be necessarily known to them in the performance of their office. They are not liable for publishing reports in good faith based on dealings furnished by the ordinary managers and clerks whom they employ.

22. Directors when accepting office impliedly agree to retain them until the next election. They may, though, at any time resign.

(*a*) Those who wish to terminate their liability by

resigning should express their wish in an orderly manner, so that new directors may be elected.

(*b*) They cannot escape from a liability already incurred by ending their relationship; they are also chargeable for losses afterward resulting from any breach of duty previously committed. In one of the cases it was held that a director who had resigned could not be held liable under the statute rendering the directors liable for failure to file annual reports, although the resignation had not been accepted and entered on the minutes of the corporation.

(*c*) Again, they cannot terminate their agency or accept the resignation of others when such action would leave the company without proper care and protection.

23. A distinction has been made between the obligation of directors to act as agents or business managers of a corporation and their obligation to perform those ministerial duties which are necessary to perpetuate the corporate organisation. They cannot divest themselves of their legal status as part of the corporate organisation save in the manner prescribed by law. If their term of office is fixed by the charter at a defined period they continue legally to be officers of the company, and are bound to call meetings and to do such other ministerial acts as are necessary to protect the company until their term of office has expired or their resignation has been properly accepted.

24. The authority of the president and other general officers will now be considered. Their authority is defined either by statute or charter, or by the common law. Whenever specific duties and liabilities are pre-

scribed in this way they have authority to act within the scope and usages of the business to which their conduct relates, and are liable if they exceed them. Thus, if a person is a general agent of an insurance company, he has authority to transact the business falling within the limits of such general agency. In other words, he can go as far in binding his company by his acts as the agent of an unincorporated principal. As the United States Supreme Court has remarked, "Corporations are liable for the acts of their servants while engaged in the business of their employment in the same manner and to the same extent that individuals are liable under the same circumstances." A cashier of a bank, therefore, would bind his institution by his acts so far as they were within the scope or usage of the business, even if in doing so he violated his private instructions. If, for example, he had no authority to certify a check beyond the maker's deposit, and should do so, the bank would be bound by his act, because it is within the scope of his authority to certify checks. A corporation can act through an attorney like an individual.

25. The tendency of the times is to endow the general officers of a corporation with more authority than they once possessed; in other words, to enlarge the general scope of their authority. This is because the old feeling of prejudice and fear concerning corporations has diminished, and their efficiency often consists in endowing their leading officers especially with greater authority.

26. Within a few years the authority of a bank presi-

dent has been enormously enlarged with judicial sanction. Formerly it was of the most limited character, but his efficiency as a manager and the requirements of modern business both unite in endowing him with the most general authority. In the large cities especially the president is usually the real head, and is responsible for the conduct of the bank's business. In a recent case Judge Hawley thus concisely expressed the authority now vested in such an officer: "It is now well settled by the weight of reason and authority that whenever in the usual course of the business of a corporation the president or other officer has been allowed to manage and control its affairs, his authority to represent and bind the corporation may be implied from the manner in which he has been permitted by the trustees or directors of the corporation to transact its business. The acting head of a corporation, whether it be the president, vice-president, cashier or general manager, through whom and by whom the general affairs of the corporation are transacted which custom or necessity has imposed upon the officers — such acts being incident to the execution of the trust imposed in him — may perform them without express authority, and in such cases it is immaterial whether such authority exists by virtue of his office, or is imposed by the course of business as conducted by the corporation." [1]

27. It is true that he does not possess as much authority everywhere, nor under all conditions. In many of the country banks the cashier is still the real

[1] Cox v. Robinson, 48 U. S. App., 388, 400.

head, and the president is clothed with no more authority than he had formerly. When, therefore, this question arises it must be determined by statute and usage or custom. But the strong tendency is to clothe the president with more authority by reason of the fact that he has become manager. But where he is merely a nominal officer his authority is no greater than in the earlier day.

28. There is a peculiar class of cases in which the authority confided in a company's officers may be gradually extended. Thus, a man when appointed to a given position may be very young and the directors are unwilling to confide much authority in him. As he grows older and becomes more efficient his authority is enlarged until, after several years, perhaps, it is practically unlimited. A change is therefore gradually going on from the time of his beginning until the complete extension of his authority. In these cases, which are quite numerous, the authority under which a person acts in performing a given thing must be largely a matter of inquiry. This is especially so with regard to all acts that are outside of the clear lines of his general authority.

29. It is often said that the vice-president takes the place of the president during his absence, and is clothed with his authority. When the by-laws specially state that, in the absence of the president he is to exercise his powers, then, unless the by-laws contravene a fundamental law, he doubtless can act in every respect in the president's place; but usually the by-laws do not confer on him as much authority, and there are

very good reasons for withholding it, as he often possesses less ability and knowledge of the company's business.

30. Corporation agents may be appointed in the same manner as agents for an individual. No formalities are required nor need a corporate seal be used unless required by charter.

The appointment does not go into effect until acceptance by the appointee. This may be presumed from the exercise of the power conferred, or from acquiescence with knowledge of the resolution of appointment.

Again, a person who is allowed to act as an agent with the knowledge of a superior agent who would have authority to appoint him, thereby binds the corporation, and it cannot thereafter repudiate his agency.

The authority of lesser agents often depends upon custom and modes of dealing with the company. Thus, the secretary and treasurer of a company may have no authority by virtue of his office to sell corporate property; yet he may be invested therewith by specific authority by a course of dealing.

31. Every officer is bound to serve his company faithfully and is as liable for wrongs committed against it as to a stranger under similar circumstances. If, therefore, he is guilty of an unauthorised act, or misapplies the corporate property, the corporation may hold him responsible for the wrong.

32. The remedy usually is an action at common law for damages. Sometimes the remedy must be in equity. Again, the corporation may treat the

transaction as binding and charge the officer for the profits received, or it may repudiate the contract and proceed against him accordingly. [1]

33. Sometimes the officers of a corporation wrongfully deal with its property, whereby the interests of creditors and stockholders are seriously injured. Then they may maintain a bill against the company and its officers for such relief as the case may require. If, for example, the officers have voted large salaries to themselves and are absorbing all the profits of the company, the court may grant relief. There was a time when it was very difficult for stockholders to obtain relief except by electing new directors, who in turn would elect new officers; this method has proved to be too slow and ineffectual. As the officers might ruin a corporation before electing others, the courts now, on the making out of a proper case, will grant more speedy relief. The stockholders or creditors must show that they have applied to the officers to correct the evils of mismanagement, and that they have failed to do anything to lay a proper foundation for granting direct relief. The officers are clearly liable for their wrongful acts to individuals, for the conversion of property or injury thereto. Thus, any agent who should convert, lose or destroy property deposited with a company for safekeeping as a pledge, would be liable therefor to the owner. His liability is entirely independent of any which the company may have incurred. If it should contract to keep the property safely it would be liable to the owner for

[1] See next Sec., § 15.

a breach of this contract; if an officer should do wrong with respect to it while acting within the scope of his employment it would be liable for his wrongful conduct. On a similar principle officers of a corporation who knowingly participate in any misapplication of a fund held by their corporation in trust are liable to the beneficiaries.

An officer is not liable to persons dealing with him in his representative capacity unless he is guilty of fraud. But if he should induce parties to contract with him by falsely representing the extent of his powers, or by falsely representing the existence of facts from which his authority to make a contract would be inferred, he would be liable.

§ 4. Wrongs of Corporations

1. Corporation may commit a wrong.
2. Malicious suits.
3. Trespass.
4. Criminal suits. Nuisances.
5. Negligence.
6. Statutory offences.
7. Contracts with promoters.
8. When corporation is not responsible for them.
9. Its responsibility by adopting them.
10. Corporation cannot ratify such a contract.
11. Relation between shareholders and corporation.
12. Courts will adequately protect them.
13. Authority of shareholders over agents.
14. Shareholders cannot dictate policy to directors.

15. In some cases may demand their removal.
16. Must make demand before suing.
17. Complainant must be qualified to sue.
18. Estate of corporation is continuing.
19. Shareholder can sue for dividend declared just before his purchase.
20. Limitations on right of purchase.
21. Shareholder cannot recover for non-performance of duty.
22. Distinction between individual and corporate rights of shareholders.
23. Remedy for impairment of value of stock.
24. Remedy when refusing to pay dividends.
25. Shareholder's right to inspect books.
26. Rights of minority holders.

1. As a corporation is impersonal, it cannot possibly commit a wrong or tort, like a natural person who cannot commit slander by deputy. But a corporation, through its agents, may commit a wrong or tort like an individual. Once, indeed, in law, a corporation had no soul, was not a being in the sense of possessing a moral quality, and therefore quite incapable of doing wrong. At last, the courts learned that officers of corporations too often assaulted persons; published libels; made wrongful representations; in short, committed numerous misdeeds for the corporations they represented. Having learned these things, legal tribunals everywhere now hold that a corporation, through its officers and agents, can commit almost any kind of wrong for and in behalf of the cor-

poration they represent and render it liable therefor.

2. The mental attitude also of its servants may be imputed to the corporation; therefore it may be guilty of malice, may be punished for a libel, for a malicious criminal prosecution, or for a malicious attachment and for conspiracy, false representation, other acts, and the like. Indeed, a corporation may be held liable, not only for actual damages resulting from a malicious wrong, but even for exemplary damages in cases where a natural person would be held liable.

3. Again, should a majority of the stockholders by vote direct an agent to enter unlawfully on the land of another, the corporation would be guilty of trespass. So, too, a corporation, like a natural person, is liable for any act committed by its servants in the conduct of its business and in the course of its employment.

4. Again, a corporation may be criminally responsible for an omission to perform a duty imposed by law. In some states, not in all, it may be criminally responsible for maintaining a nuisance. An indictment will lie against a corporation for misfeasance as well as for non-feasance, provided the offence contains no criminal element. Thus, corporations have been repeatedly held liable for a nuisance by obstructing a navigable river or other public highway. A corporation has been indicted for a nuisance in keeping a disorderly house and for permitting gambling on its premises.

5. Again, a corporation is liable for the negligence of its servants or agents to perform any duty which

ought to be done by the corporation itself. Thus, a railroad company is liable for negligence in running its trains or for keeping its premises in an unsafe condition.

6. By statute also corporations are made liable for the wrongs committed by their officers. Thus, a national bank officer who certifies a check without enough money on deposit to pay it violates the law and is liable to prosecution and imprisonment.

7. Some important questions have arisen between a corporation and its promoters, who have been efficient in creation. The word promoter has no technical legal meaning and applies to any person who takes an active part in aiding the formation of a company.

8. A corporation is not responsible for the acts performed or the contracts made before it came into existence by promoters or other persons assuming to bind in advance the company. It cannot be held liable on any legal principle whatever, for the reason that no relationship can exist between the two until the company has been formed.

9. A corporation may become responsible for the acts of a promoter and his contracts by subsequently adopting them. Such action is not a ratification for the simple reason that the company cannot ratify, but the effect is the same. The company becomes responsible through adoption.

The offer implied in the agreement with promoters assuming to act in behalf of the proposed corporation may be accepted by the latter, either at the time of its formation or afterward. Says Morawetz, if the

charter or articles of association of a company refer to the agreement and provide that the company shall become a part thereof, it is evident that the agreement would be binding upon the company from its inception by reason of the unanimous consent of the shareholders. A similar rule applies when two companies form a new company by consolidation, and this is made a party to the contracts of the old company by an agreement of consolidation.

The adoption of an agreement made by promoters may often be implied from the acts or aquiescence of the corporation or its agents without express acceptance. After a corporation has knowingly received the benefit of such an agreement it is bound thereby.

10. A corporation cannot ratify the acts of a promoter, because this operates retrospectively and amounts to an original grant of authority. By virtue of this doctrine a principal is made responsible for the act of an agent to which it was not a party by simply giving its assent. On the other hand, by adopting an agreement made with promoters, a new agreement is created which is governed by all the laws applicable to the formation of the contract.

11. The relation between a corporation and its several members for many purposes is that of a trustee and beneficiary. In law the property and rights of a corporation belong to the corporation itself as an entity and not as the shareholders. They, however, are the real parties in interest. The nature of the trust is declared in the charter. Says Justice Blackburn, as the shareholders are in substance partners

in a trading corporation, the management of which is entrusted to the body corporate, a trust is by implication created by the shareholders that the corporation will manage the corporate affairs and apply the corporate funds for the purpose of carrying out the ordinary transactions.

A corporation may ratify an unauthorised transaction through its shareholders, either by unanimous action or by a majority, if the transaction was of a character which might have been authorised by a majority in the beginning.

12. The courts will in all cases provide an adequate remedy for the protection of the rights of shareholders. But if a short delay would enable a corporation to act for itself without irreparable injury, a court would perhaps delay action. It will also grant immediate relief when the managers wrongfully refuse to defend suits brought against the corporation. In such a case a delay until a meeting of the stockholders might be fatal by subjecting the corporation to a judgment. To obtain an injunction for the protection of its rights a corporation must show that the injury is threatened for which no other remedy would be adequate. It would seem to follow, therefore, says Morawetz, that whenever a corporation is entitled to an injunction to protect itself, and is not able to supply the remedy, a shareholder may obtain relief for the protection of its interests. Whatever would be an irreparable injury to a corporation would necessarily be a similar injury to its members.

13. The majority at a shareholder's meeting have

no power to revoke the powers of an inferior agent because the power to appoint him is delegated exclusively to the board of directors. Nor have the shareholders implied authority to revoke the powers of the directors or managing agents when their term of office is prescribed by the chartered articles of association or by-laws of the company.

14. The shareholders have no authority to dictate what policy the directors shall pursue, or impair the discretion imposed in them. Says Morawetz: If shareholders are dissatisfied with directors whom they have elected, their remedy is to elect other agents at the time and in the manner prescribed in the charter. It would be a violation of the charter contract and a violation and a wrong to every dissenting member to permit any portion of the shareholders to interfere with the discretionary powers which were intrusted to the agents of the corporation alone. Until a mistake on the part of the directors, individual stockholders have no right to appeal to the courts to define the line of policy to be pursued by the company. In applying this rule shareholders cannot interfere with the discretion of the directors in instituting legal proceedings for the benefit of the corporation, nor complain when they have instituted a suit which, in their judgment, should not have been begun. This principle has had many applications and the courts are quite unanimous in sustaining the action of directors so long as they act within the discretionary authority given them.

15. Cases may arise in which the removal of direc-

tors is essential to the company's welfare. Thus, they may be unable or unwilling to perform their duties and even threaten the company with mismanagement and financial ruin. In such cases the courts will grant relief on the request of the shareholders whenever the company is unable to maintain its rights, but it must be remembered that in all cases of mismanagement, fraud, and the like, the wrong perpetrated by the directors, or sought to be, is to the company and not to any individual shareholder. It is needful, therefore, for the company to proceed against the directors for relief. Sometimes the company is so completely in the control of directors that it is quite impossible to proceed against the offenders; especially when all the directors, or nearly all, are conspiring or acting together to defraud or mismanage. In such cases the stockholders must proceed in the name of, and in the behalf of, the company, and when a case of this kind is clearly made out the courts will take cognisance of it and proceed to grant such redress as the occasion requires.

The courts will not remove directors from office, or restrain them from representing the corporation, save in a case of absolute necessity. A court has less hesitation to issue an injunction to restrain them from specific threatened wrongs. When the powers of the directors are revoked by order of the court, a receiver should be appointed until a meeting can be held and new directors elected by the majority.

16. Before shareholders can proceed in behalf of the corporation a demand to act is usually necessary

on the proper agents; in other words, a shareholder who asks the court to interfere with the management of a corporation and to grant relief by reason of mismanagement, must show that the directors or managing officers have control and refuse to act on its behalf. But the demand is not necessary when directors are in full control, or cannot be made, for example, after their resignation or flight to a more serene country.

17. The suit of a complainant who is personally disqualified from suing cannot proceed, though the other shareholders are entitled to relief, nor can the shareholder who has acquired his share after an unauthorised transaction has taken place complain on the ground that he has suffered wrong, or that his rights have been infringed.

18. The estate of a corporation is to be treated as continuing regardless of its members, each share representing an interest in the entire concern, and the several holders are entitled to equal rights irrespective of the time of acquiring shares. A shareholder, therefore, has an interest in all causes of action belonging to the corporation, whether they arose before or after purchasing. If the courts decline to protect his interest in any case its refusal must be based on some principle of public policy or the plaintiff's personal disqualification.

19. A shareholder is permitted to sue on causes of action which arose before he purchased his shares, assuming, of course, that the corporation ought to sue, but is unable to act. If purchasers were thus

disqualified from protecting their interest the transferable value of shares might be impaired. It is not material that the plaintiff knew of the wrongs before purchasing; courts cannot investigate the secret intentions of parties or refuse to protect their satisfactory rights by reason of some ulterior design.

20. A purchaser of shares, however, acquires no greater rights than those of the prior holder. A shareholder who acquiesces in a violation of the corporate rights and afterward parts with his shares, extinguishes the cause of action and no future shareholder is entitled to complain. But when there has been no general acquiescence the right to sue passes to the transferee of the shares.

A purchaser of shares has at least as good a right as the prior holder to restrain the performance of an unauthorised contract made on behalf of a corporation. The purchaser is entitled to insist that the corporation's agents shall do their duty after he has become a shareholder. He may insist that they shall not misapply the company's funds and place its franchises in jeopardy by doing any unlawful acts under a contract that was never binding, and if the agents do attempt any violation of their duty he can come into court and insist that his rights have been infringed.

21. A shareholder can in no case recover damages from the directors for the mere non-performance of their obligations to the corporation. This is true, although the individual rights of the shareholders may be infringed. The reason is that the directors are agents of the corporation, and not of the individual

shareholders. The corporation alone can compel its agents to do their duty or can recover damages of them for the loss caused by their negligence. The liability, so Chancellor Runyon remarks, is to the corporation in the first instance where the corporation is capable of acting, but if it refuses to do so then a person aggrieved may bring suit. If a corporation be insolvent and its affairs in the hands of a receiver, he may maintain the litigation. If he refuses, or is himself involved, a person aggrieved may sue.[1]

22. The distinction is important, yet not always clear, between the individual and corporate rights of shareholders; and also the different remedies that must be pursued against guilty directors in the two classes of cases. Thus, when the value of shares is impaired by wrongful acts affecting the property or business of a corporation, the shareholders must obtain redress through the corporation, for any relief thus obtained would enure to their benefit. It has therefore been held that shareholders cannot personally recover damages for depreciation in the value of their shares caused by embezzlement or other wrongdoing.

23. On the other hand, when the value of shares is impaired by wrongful acts affecting the shareholders directly, and not merely the value of the corporate estate, they must sue individually. Thus, if the value of particular shares is impaired by mutilating or destroying the certificate of the holder, or by creating uncertainty concerning its validity, the person

[1] Chester v. Halliard, 34 N. J., Eq., 342.

aggrieved must seek his remedy in an action against the directors.

The same rule applies to damage caused by impairing the value of the shares directly, and not through the corporate property or rights, even though every shareholder should suffer alike. Thus, should the market value of shares be impaired by false and slanderous reports, or by the issue of spurious certificates, each owner would be entitled to recover his damages directly. It may be added that the corporation itself might have a separate cause of complaint for injuries to the corporate interests. Thus, if the slanderous reports were injurious to the corporate interest or credit, or the issue of spurious certificates should result in legal liability or other damages, the corporation itself would be entitled to redress.

24. Again, after a dividend has been declared by a corporation, each shareholder has a separate individual right to the amount due on his shares, and this right he may enforce by proper action against the company.[1] On the other hand, should the directors wrongfully refuse to declare a dividend, the only method of proceeding against them would be by company, and not by individual action. No shareholder could sue for any particular portion of the undivided profits. Again, the right of a shareholder to obtain from the agents a certificate showing the number of his shares is an individual right, and likewise the right to have them transferred to another person. In these cases, therefore, should the directors fail to ex-

[1] See next Sec., § § 1, 2.

ecute his wishes, he could proceed individually for relief.

25. A stockholder is entitled to inspect the books and papers of his company for proper purposes, and should this right be denied him by its officers, he may maintain an action for the wrong he has sustained. He may also enforce his right to compel the corporation or the officer in charge of the books and papers to permit the inspection.

It is true that there is a limit to the right of inspection. The stockholder must show a good reason for making an examination, and not simply to satisfy some caprice or prank. This rule, says the Supreme Court of Rhode Island, sufficiently protects the stockholder and at the same time prevents an undue interference in conducting the affairs of the company. If a stockholder has no cause for examining the books he is not injured by a refusal of the court to permit him to make it. On the other hand, a company should not be troubled by frivolous and vexatious requests of that kind. A stockholder may be on bad terms with an officer of the corporation, and possibly may have some enmity or wrong feeling in making his examination.

A stockholder is entitled to inspection, though his only object is to ascertain whether the officers of the company have been properly conducting the affairs of the corporation; and to lay the foundation for his petition he need not first show that there has been mismanagement or that there are grounds for suspecting it.

This right of inspection may also be exercised by an agent or attorney or expert accountant for the stockholder, for were this right not given him to act through another more competent, perhaps, than himself, his right of inspection might be worthless.

Sometimes the right of inspection is given by statute, by charter, or by-laws. In Alabama the code declares that a stockholder of all private corporations has the right of inspection, and examination of the books and records of the corporation at reasonable and proper times. In construing this statute the courts declared that any stockholder has an absolute right of inspection, subject only to the limitation that it shall be exercised at reasonable and proper times and for lawful purposes. He is not required to show any reason or occasion, says the court, rendering an examination opportune or proper or a definite or legitimate purpose. The custodian of the books or papers cannot question or inquire into his motives and purposes.

26. Much discussion has been had of late concerning the rights of minority stockholders, and also what they can do in correcting the misdeeds of directors. Once it was held that after the directors were chosen little could be done in the way of interfering with their action unless they were guilty of positive infringement of the law. Experience has taught the courts that it is needful often to interfere with greater promptitude than through the election of new directors who will attend more faithfully to their duties. Accordingly, it is now held that stockholders may appeal

to a court of equity for an examination into the condition of affairs whenever the facts are of such a nature as to show clearly that they are not directing the affairs of the institution properly.

§ 5. Dividends

1. What are dividends.
2. Until declared are part of the assets.
3. Until declared shareholders have no claim to them.
4. Afterward shareholders can recover.
5. If company becomes insolvent dividends belong to shareholders.
6. How dividend must be declared.
7. Dividend must be earned.
8. Cannot be declared out of borrowed money.
9. Interest and surplus.
10. Premiums of an insurance company.
11. Profits of mining corporation.
12. Directors cannot declare dividends out of capital.
13. Reclamation of illegal dividends.
14. Lawfulness of dividends must be considered from time of making it.
15. Reduction and diversion of capital.
16. Declaration of dividend is largely discretionary.
17. Directors must not abuse their discretion.
18. Distribution of dividends.
19. Recent owner cannot be excluded.
20. Legatee is not entitled to profit until dividend is declared.
21. Only stockholders of record are paid.

22. Pledgee's right to dividend.
23. In what paid.
24. Stock dividend.
25. Retention of dividend to pay stockholder's indebtedness.
26. Rights of assignee before declaring a dividend.
27. Who receives dividends declared after a bequest.
28. Does a stock dividend go to the legatee or is it a part of the estate?

1. The dividends of a corporation consist of that portion of its profits which are declared or set apart by the directors for division among the shareholders. They are the net profits, or the surplus profits after deducting the capital, expenses of management and losses that may have been sustained.

2. Until dividends are declared the profits are a part of the assets of the company and do not belong to the stockholders individually. There is no debt in a legal sense due from the corporation to them. It follows that should the company become insolvent before setting apart its profits for the stockholders by declaring a dividend, they must all be applied to satisfy the debts of the concern.

3. Again, until a dividend has been declared the stockholders cannot maintain an action against the corporation to recover their proportion of the profits, but their remedy, if having one at all, is to compel the directors to declare and pay a dividend.

4. After declaring a lawful dividend each stockholder becomes vested with the portion due to him;

nor can the board afterward without his consent revoke its action and refuse to pay it.[1]

5. Furthermore, should the company become insolvent, the stockholders would still have a right to the dividend as against the creditors. But the dividend must have been fully declared to vest the profits completely in them; therefore, if a dividend has been voted but not made public nor reported to the stockholders, and no fund has been set apart for its payment, the vote may be rescinded.

6. The statutes are specific in declaring when dividends may be declared, and provide that they must be paid out of net profits. In no case can they be taken out of the capital. The object of this provision is to prevent its impairment and the corporation's insolvency. The statutes usually impose penalties on directors who violate this provision.

7. The temptation on the part of directors is often great to declare dividends that have not been earned for the purpose of preserving the credit of the company, possibly hoping that it may recover itself; more frequently for the purpose of deceiving outsiders, maintaining the value of the stock and parting with it before the true condition of things is known. This is an ancient game, many times played by directors, notwithstanding the judgments and penalties heaped upon them for their wrong-doing.

8. Dividends cannot be declared out of borrowed money, for this is no profit, although money may be borrowed temporarily for this purpose. This is

[1] See Sec. IV., § 24.

occasionally done by a corporation that has used its dividends for some other legitimate purpose.

9. Interest also accrued but not paid is not a surplus profit within the meaning of the statute prohibiting a corporation from paying dividends except from surplus profits. This rule, however, may be questioned.

10. The capital stock of an insurance company is not the primary fund for paying losses, but the premiums received for insurance and the interest on the capital stock constitute such a fund. Therefore, unearned premiums on which the risks are still running are not surplus profits out of which dividends can be legally declared without leaving a sufficient surplus to meet probable losses on risks assumed but not yet terminated.

11. The profits of mining corporations subject to distribution are the net proceeds arising from its operation without any deduction for decrease in the value of the mine by reason of taking out ore; and the same principle applies to all corporations organised for the purpose of utilising a wasting property like a mine or a patent. Such a corporation is not regarded as distributing its capital even by dividing all of its net proceeds, though the value of the property is necessarily decreased. Excepting such cases, before profits can be lawfully set apart as a dividend, a proper sum must be set aside to represent the wear and tear of the plant of the corporation for the purpose of creating a fund to renew and improve it.

12. Directors cannot lawfully diminish the capital by way of division among the stockholders. Such

action, taken in good faith, does not render them liable to the corporation or to creditors, but when taken for a fraudulent purpose, or through gross negligence, they are personally liable both to the corporation and to creditors.

13. Dividends illegally declared and paid, not based on profits, may be reclaimed either by the corporation or by its assignee for the benefit of creditors themselves. Says Clark: the fact that the directors acted in good faith under a misconception as to what constituted the profits of the company out of which dividends were payable, is immaterial, for the recovery of the corporation may be sustained on the principle which allows the recovery of money paid under a mistake. If the capital stock is wrongfully paid away by the directors it may be pursued by the creditors into the hands of anyone who is not an innocent purchaser or a recipient of the same for a valuable consideration. If such a wrong is threatened a creditor may maintain a bill in equity for an injunction.

14. In deciding whether a dividend was rightfully made or not the transaction must be viewed from the time of making it and not afterward.

15. A corporation cannot reduce its capital by virtue of statutory authority and distribute among the stockholders an amount equal to the difference between the original capital and the new capital without regarding the present value of the property. It must therefore retain property equal in value to the amount of the reduced capital over and above its debts.

16. Whether a dividend shall be declared, and also the amount, are questions lying largely within the discretion of the directors, with which the courts rarely interfere. The stockholders are not entitled as a matter of right to a dividend whenever the annual earnings exceed the liabilities of the company, though there may be a large surplus; the board may, if they think the interests of the corporation require, expend the entire income in making improvements or extending the business of the corporation or perhaps retain it as a surplus fund.

17. Directors are not permitted to abuse their discretion nor to use their power illegally or abusively. They must act in good faith. If the right to a dividend is clear, and there are funds to pay it, a court of equity will compel its declaration. Not infrequently, when new corporations are started, it is understood that dividends are to accumulate until they amount to a large sum. Of course, in doing this, a stockholder obtains the full value of his stock, for, should he desire to sell, it would be worth his proportionate share of this dividend. Sometimes cases happen in which directors have some ulterior purpose in not declaring dividends, and stockholders are obliged to appeal to the courts for redress.

18. Dividends must be distributed among the stockholders at the time of declaring them, regardless of the time during which the profits were earned or the length of time that anyone has been a stockholder. Directors have no right to discriminate against stockholders unless this can be done by virtue of a special

contract existing among them. Said the court on one occasion, "the dividends must be general on all the stock so that each stockholder will receive his proportionate share. The directors have no right to declare a dividend on any other principle. They cannot exclude any portion of the stockholders from an equal participation in the profits of the company." [1]

19. A person who becomes a stockholder immediately before declaring a dividend is entitled to his proportion, nor can the directors exclude him. In one of the cases a person held bonds of a corporation, convertible into stock, who surrendered them and received stock therefor. Shortly afterward a dividend was declared. The owner of the bonds thus converted into stock was entitled to his proportionate share, the same as any other stockholder.

20. As a stockholder is not entitled to any portion of the profits until the declaration of a dividend, a legatee is not entitled to the dividend on any share declared before, but payable after, the death of the testator. The dividend forms part of the body or corpus of the estate and passes to the executor. Therefore, should the owner of stock direct by will the income to be paid to his widow, and die after a dividend has been declared, but before its payment, the executor could properly insist on receiving it as part of the estate.

21. A company usually is protected in paying only to the persons who appear on the books as owners. A company that has notice of a transfer will be liable to

[1] Ryder v. Alton & Sangamon R., 13 Ill., 516.

the transferee or his assignee for dividends that are subsequently declared, even though the transfer is not registered.

22. The pledgee of stock whose name appears on the books of the corporation, or whose rights are known thereto, is entitled to dividends subsequently declared as between himself and the corporation, and it will be liable to him if paid to the pledgor.

It is a common practice in pledging stock to declare in the pledge that the pledgee shall be entitled to the income.

23. If nothing is said by statute concerning the payment of dividends in cash the directors may make them payable in cash or in property, or they may declare a stock dividend. If the dividend is payable in cash the corporation becomes a debtor and must discharge the debt like any other debt which it may owe, in lawful money.

24. A corporation that has the right to increase its capital stock may issue stock as a dividend instead of distributing the profits in the way of money among the stockholders. This is called a stock dividend. Such a dividend, if the stock is issued only to the extent of the surplus profits, is not a violation of the prohibition against reducing or withdrawing the capital stock by distribution among the stockholders.

25. A corporation may retain dividends to apply on any indebtedness due from stockholders. This right of retention does not rest on any lien the corporation may have on the owner's stock to reimburse

his indebtedness, but on the right of set off, for the dividend is a simple debt owing to the stockholders.

26. After shares have been assigned and followed by notice of the assignment to the corporation, before declaring a dividend the right thereto passes to the assignee, and the corporation cannot set off a debt due from the assignor incurred before the assignment.

27. Dividends declared after a grant or bequest takes effect, but earned before, go to the grantee or legatee as income or profits.

In some states a different rule prevails. Thus in Pennsylvania it is maintained that when the stock of a corporation is by the will of the decedent given in trust, the income thereof for the use of the beneficiary for life with the remainder over, the surplus profits accumulated during the testator's life, though not divided until after his death, belong to the corpus of his estate, while the dividends of earnings declared after his death are income and payable to the beneficiary, no matter whether the dividend be in cash, script or stock.

28. In declaring a stock dividend the question has arisen whether the new stock goes to the legatee or receiver of the income, or forms a part of the body of the estate and goes to the remainder man. In Massachusetts cash dividends, however large, are income, and go to the grantee or legatee of the income. Stock dividends, however made, are an increase of the capital, and should be kept for the remainder man. This view prevails in many other states, though not everywhere.

§ 6. Beneficial Associations

1. Nature of beneficial association.
2. Some business associations are called beneficial.
3. Beneficial societies may be voluntary or incorporated.
4. Articles of association are an agreement.
5. Legal status of unincorporated association.
6. Are the members partners.
7. Liability of member for a thing sold to his association on his credit.
8. When liability begins.
9. Association may change its purpose.
10. How members must exercise their right.
11. Member has no proprietary interest in association's property.
12. When voluntary association becomes liable as a corporation.
13. Property of divided society.
14. To what extent are benefit societies charities.
15. Articles of association or charter regulate admission of members.
16. How far courts will go in determining membership.
17. Effect of false representation by member of his qualification.
18. Mode of admission must be observed.
19. Election must be regular.
20. One is not a member until ceremony of initiation is performed, where this exists.
21. Power of majority.

22. How controversies respecting property must be decided.
23. Payment of sick benefits.
24. To what extent benefits may be changed without notice.
25. By-laws relating to benefits must be reasonably construed.
26. How far they extend.
27. In applying for them the established mode must be followed.
28. When member can appeal to courts to test his right to benefit.
29. Corporation can expel members.
30. This is incident to every society.
31. Dropping names by revision is not equivalent to expulsion.
32. Causes for expulsion, though not mentioned in constitution and by-laws.
33. Power to expel cannot be delegated to officer or committee.
34. Power to expel does not include power to suspend.
35. Expulsion must be done in accordance with the rules.
36. This power must not be exercised maliciously.
37. Charges must be in writing. Notice.
38. In expelling a society acts in a kind of judicial capacity.
39. When courts will review the proceeding.
40. Charges must be of a serious nature to justify expulsion.
41. Acquitted member cannot be tried again.

42. Expulsion by subordinate lodges of a society.
43. Appeal from action of subordinate lodge does not abate by member's death.
44. Member need not appeal from action when it is void.
45. Restoration of member.
46. Courts seek to preserve property rights of members.
47. Withdrawal from society.
48. Notice of withdrawal bars benefit.
49. Liability of withdrawer for society's indebtedness.
50. Personal liability for promised benefit.
51. Officers are governed by general principles of agency.
52. Association cannot confer judicial powers on its officers.
53. Directors need not keep a record of their proceedings.
54. Authority of president.
55. Authority of secretary.
56. Authority of treasurer.
57. Authority of trustees of an association.
58. Right of contributors to a fund given to trustees for distribution.

Besides the corporations already described, are others, especially beneficial and voluntary organisations, that fill too large a place in the affairs of life to pass without notice. Many beneficial associations have a long history, others are quite new; the leading principles that govern all are important to many individuals.

1. Beneficial associations are in the nature of social organisations, and the members are often bound together by secret obligations, mystic signs and fraternal pledges. Very many of these organisations are made up of local lodges.

Their beneficial character varies greatly in different organisations. Thus, the trades unions have a double nature; the beneficial nature is one side; their authority and purpose to make terms with employers is another side. In some labour organisations this latter feature is by far the most important, leading the members to unite and co-operate for the common end.

2. Some business corporations are also called benefit societies, because they possess this nature. All collect monthly, or at other periods, contributions or assessments, which they agree to pay their sick or disabled members on well-understood conditions.

3. Benefit societies may be purely voluntary associations, or incorporated, either, by a general law, or by a special charter.

4. The articles of association are essentially an agreement between the members, extending or limiting any general obligation that may bind them together. By such action they establish a law for themselves. This fundamental agreement is analogous to the charter of a corporation.

In one of the cases the court declared that individuals who form themselves together into a voluntary association for a common object may be governed by such rules as they think proper to adopt, provided

there is nothing in them to conflict with the law of the land. Members are presumed to know the rules, to have assented thereto, and are therefore bound by them.

5. The legal status of unincorporated societies, whether formed for religious, social, benevolent, or for beneficial purposes, is not yet clearly ascertained. The cases defining their position are sadly lacking in harmony. Abbott says that the language of many authorities proceeds on the idea that every organisation must be a corporation or a partnership. Many of the cases have been decided on this principle; but this is not the only alternative. There may be a joint or common tenancy in property; there may be a mutual or reciprocal agency in transactions for a specific purpose; there may be a well-defined organisation of the owners of such property, or of the actors in such transactions, or both. An organisation may have articles like a partnership, or a constitution and by-laws, yet not be in the eye of the law either a partnership or a corporation. [1]

6. Persons who associate for the purpose of benevolence, charity, or any other lawful object, beside trade or business, are not generally regarded among themselves as partners. But in settling their disputes, in dividing their property, especially in determining their liabilities to their creditors and in winding up their society, legal tribunals generally treat the members as original partners, the association as a partnership, giving effect as far as possible to the articles of association.

[1] Note to 4 Abb., New Cases, 300.

The Court of Appeals of New York has considered this question in the case of an unincorporated lodge of a benevolent society, called the "Independent Order of Rechabites." Having been mismanaged, the members sought to dissolve the lodge, wind up its affairs, and distribute its property. The court declared that associations of this nature were not usually partnerships. There was no power to compel payment of dues, and the rights of a member ceased after his failure to meet his annual subscription. This particular society certainly was not a partnership. Its purpose was not business, trade or profit, but the protection and benefit of its members.[1]

But in another case of a voluntary association, called the Worth Club, the members were held personally liable to its creditors by the application of common law principles. Said the court: "Where such a body of men join themselves together for social intercourse and pleasure, and assume a name under which they commence to incur liabilities by opening an account, they become jointly liable for any indebtedness thus incurred, and if either of them wishes to avoid his personal responsibilty by withdrawal from the body, it is his duty to notify the creditors of such withdrawal."[2]

7. If one or more members order work to be done or supplies furnished, he or they are personally liable unless credit was given to the association.

8. Their liability as members attaches by signing

[1] 81 N. Y., 514.
[2] Park v. Spaulding, 10 Hun (N. Y.), 128.

the articles of association, and continues until notice of withdrawal is given.

9. An association cannot change the purpose for which it was organised without the consent of all the members. The executive board cannot convert it into a corporation unless power has been expressly conferred upon them.

10. Members must exercise good faith toward one another, and observe the provisions or their articles of association in regard to property, even though this course may not be for the interest of the concern, and may be against the will of the majority.

11. A member has no proprietory interest in the property, nor right to any proportionate part, either during his continuance or withdrawal from membership. He has merely the use and enjoyment of it and nothing more, for the property itself belongs to the society. After the closing of a society, its members may divide the property among themselves.

12. A voluntary association may, by holding itself out as a corporation, be forbidden from denying its corporate capacity to the injury of third persons. It is a familiar rule of partnership law that a person who transacts business with a partnership in the partnership name may hold the members liable as partners, although he did not know the names of all. Their liability is founded on the reason that they are actual partners as between themselves.

13. Sometimes there is a division in a society, and grave questions arise with respect to its property. One rule exists of extensive application. In an association

or branch, under the control of a general organisation, there may be a schism or division; two parties may be formed. The faction or party that adheres to the laws and usages of the general organisation constitutes the true association, and is entitled to the enjoyment of the association's property, even if the members be in a minority, provided they are enough to continue the existence of the association.[1]

In one of the cases the majority of the members of a lodge withdrew from the jurisdiction of the grand lodge and surrendered the charter, while the minority remained true to their allegiance; it was decided that the faithful few were entitled to the charter and property of the original lodge.[2]

Societies of a *quasi* religious character exist to which a member, after joining, surrenders his property and receives support. In one of these cases a member, contrary to rule, left the community and brought an action to recover compensation for his services and also his share of the community property. He did not succeed.

14. To what extent are benefit societies to be regarded charities? This is important with respect to taxation, as charitable associations are taxed either very lightly or relieved altogether from this burden. The Supreme Court of Indiana has decided that a corporation which promises to pay a certain sum as a benefit during a member's illness, in consideration of his payment of dues, is not a purely benevolent

[1] Merion Benevolent Ass'n v. Martin, 67 S. W. (Ky.), 38.
[2] Altmann v. Benz, 27 N. J., Eq., 331.

organisation; it may be, and doubtless is, benevolent and charitable to a great degree, but is not a benefit organisation in the sense of a distinct benefit without a consideration. Masonic lodges have often been held to be charitable and exempt from taxation. Says the Supreme Court of Pennsylvania: "The true test is to be found in the objects of the institution. Where these are to advance the interest of a party, of an association, of a private corporation, of a religious denomination, and the like, however beneficial to the public their growth and success may be, there is a private object to gain; and the institution is not unqualifiedly public." [1]

15. The articles of association, or charter, regulate the admission of members and define their qualifications. One who is wrongfully admitted can be expelled; nor is a society bound by the acts of its officers in admitting a person illegally. Unless a statute declares otherwise, minors may be legal members with the same rights and liabilities as adult members.

A statute required all practising physicians to become members of a medical society. A physician who applied was rejected because of unprofessional conduct contrary to the society's by-laws. A code of medical ethics adopted by the society was declared to be binding on the members alone, and its non-observance previously to membership no legal cause either for exclusion or for expulsion.

16. The courts will not ordinarily determine whether

[1] Burd Orphan Asylum case, 30 Pa., 29.

a member possesses the denominational, physical, or other peculiar qualification required by a society for membership. Thus, a court not long since declared that men who associate themselves with others as organised bodies professing certain religious views, or holding themselves out as having certain ethical or social objects, and subject to a common discipline, have voluntarily submitted to the society of which they are members, and it is for that society to know its own.

17. When the membership of a society is restricted to certain occupations a false representation respecting one's occupation avoids his membership.

18. The mode of admitting new members prescribed by the articles of association, or by the charter, must be observed. If no form of election has been prescribed action on each candidate must be separate. Says Bacon: If a list of several be proposed the election will be void, although the names were read over several times and all assented, for it may be presumed that the members, instead of using their individual judgment on each candidate, compromised their opinion as to some in order to secure the admission of others.

19. The election must be at a regular meeting, or at one properly called. A call, therefore, for a special meeting stating that it is to transact any business that may legally be presented is not sufficient for admitting and electing members.

20. Sometimes a society requires a ceremony of initiation. A person regularly elected a member

of such a society is nevertheless not entitled to benefits without a proper initiation. Nor is secrecy of the ceremony material, for this is not against public policy. In one of the cases the court said: "Were the ceremonies open they could not be said to be unreasonable; because they are secret does not make them so. The entire system, its existence and objects, are based upon initiation. We think there can be no membership without it, and no benefit, pecuniary or otherwise, without it." [1]

21. The fundamental principle of every self-governed association is that no one shall be bound except with his own consent. While this is true, the will of the majority is also the will of the whole. This is an essential of all associations.

22. Controversies concerning property rights of religious societies are generally decided by one of three rules.

"(1) Was the property or fund which is in question devoted by the express terms of the gift, grant or sale by which it was acquired, to the support of any specific religious doctrine or belief, or was it acquired for the general use of the society for religious purposes with no other limitation?

"(2) Is the society which owned it of the strictly independent or congregational form of church government, owing no submission to any organisation outside of the congregation?

"(3) Or is it one of a number of such societies, united to form a more general body of churches, with

[1] Matkin v. Supreme Lodge, 83 Tex., 301.

ecclesiastical control in the general association over the members and societies of which it is composed?

"In the first class of cases the court will, when necessary to protect the trust to which the property has been devoted, inquire into the religious faith or practice of the parties claiming its use or control, and will see that it shall not be diverted from that trust. If the property was acquired in the ordinary way of purchase or gift, for the use of a religious society, the court will inquire who constitute that society, or its legitimate successors, and award to them the use of the property. In the case of the independent order of congregation this is to be determined by the majority of the society, or by such organisation of the society as by its own rules constitute its government. In the class of cases in which property has been acquired in the same way by a society which constitutes a subordinate part of a general religious organisation, with established tribunals for ecclesiastical government, these tribunals must decide all questions of faith, discipline, rule, custom, or ecclesiastical government. In such cases, where the right of property in a civil court is dependent on the question of doctrine, discipline, ecclesiastical law, rule or custom, or church government, and that has been decided by the highest tribunal within the organisation to which it has been carried, the civil court will accept the decision as conclusive, and be governed by it in its application to the case before it." [1]

23. Many benefit societies provide for the payment

[1] Bacon on Benefit Societies and Life Insurance, § 77, p. 128.

of money to their sick members. A member of a beneficial society is not a creditor, and he can claim only the benefits prescribed in the by-laws existing at the time of his application for relief. A by-law is not an unalterable contract except with his consent. As a Supreme Court has said: "In these societies the rights of the members may be taken away by the alteration of the constitution without notice, unless the constitution provides otherwise." In a case involving the question the court said the complaining person was bound by the charter. The charter gave no right of action. The constitution and by-laws were liable to change. The changes were made in the way pointed out in the constitution and by-laws.

24. In another case the court held that as both the laws of the state and the by-laws of the society gave the right to repeal or amend its by-laws, a by-law providing that a member in the case of sickness should receive $10 a week could be amended by limiting the allowance to a certain number of weeks thereafter, though the member was sick at the time of passing the amendment.

25. Like other by-laws, those relating to benefits must be reasonably construed. Thus, a by-law provided that any member who became unable to work in consequence of sickness or accident should receive a certain sum per week. A member by trying to resume work, and working two days during the period of his sickness, did not debar himself from receiving benefit during the time, as he was unable to work within the meaning of the by-laws.

26. Provisions for benefits in case of sickness do not extend to bodily injury.

27. A member in applying for benefits must follow the modes prescribed. In a Georgia case the Supreme Court said whoever became a member of a society in controversy, could only avail himself of the rights to be enjoyed in the way and manner provided by its own rules. This principle has been affirmed on many occasions, and is founded on the highest reason.

28. If by-laws provide for no tribunal to test the right to a benefit a member may have an immediate right of action, and an action lies to enforce the award of the lodge, or the society tribunal. Moreover, a society which agrees in consideration of dues to pay a certain sum as benefits during a member's illness cannot deprive him of his right to resort to the courts in the event of a dispute concerning its payment.

29. A corporation that is duly organised has power to make by-laws and expel members, though the charter be silent on that subject. If the power be expressly granted in general terms, it is conferred to enable the corporation to accomplish the objects of its creation.

30. The power to disfranchise or expel members is incident to every corporation and society, unless formed primarily for the purpose of gain. In a recent case Judge Goode declared: "Corporations organised for gain have no power for expulsion or forfeiture, unless granted by their charter or by general municipal laws."[1]

[1] Purdy's Case, 18 Amer. & Eng. Corp. Cases, 508.

31. The revision of the membership list by the dropping of names from the roll is equivalent to expulsion of the names of persons whose names are stricken off. This cannot be done save by the vote of a society, at least a majority of the members present voting in the affirmative.

32. There are three causes for expelling a member, even if nothing be said about them in the charter or by-laws of an association. First, for an offence of such an infamous nature as renders him unfit for the society of honest men — perjury, forgery, and the like. Of course, there must be previous conviction by a jury. Second, for an offence against his duty as an incorporator. In that case he may be expelled after trial and conviction by the corporation. Third, for an offence of a mixed nature, which is indictable by the law of the land.

33. The power of expelling a member from a club or society belongs to the general body and cannot be delegated to a committee or officer. The transfer from the body of the society, says a court in a case of this kind, to a small faction of its members is so large and dangerous a power that it cannot be established by inference or presumption.[1]

34. The power to expel does not include the power to suspend. In a Texas case it was held that where the by-laws provided for the expulsion of a member for the non-payment of his assessment, the presiding officer of the lodge could not, without

[1] When a charter provides for an expulsion and authorises the regulation of the proceedings by by-laws, the board of directors may expel a member in conformity with them.

a vote of the members, declare the delinquent suspended.

35. In proceedings to expel the letter of the rule must be observed. This is a grave power to execute, and the law requires the utmost care in executing it. If no notice is required pertaining to proceedings against a member, none need be given. It has often been held that by-laws which provide for expelling a member without notice are void as unreasonable. Says Bacon: "Expulsion, if a property right is involved, must always be on notice, and if no other method of notice is prescribed by the by-laws it must be served personally." [1]

36. Lastly, the power to expel must be exercised bona fide and not capriciously, or arbitrarily, or maliciously.

37. Sometimes a by-law requires the charges against a member to be in writing and signed by the accuser. The notice must specify the time of hearing. By appearing, the member generally waives objection to the notice and to the character or composition of the tribunal. The accused must be permitted to confront his accuser and cross-examine him; the ordinary principles of justice and of right require this to be done.

38. In expelling a member a society acts in a *quasi* judicial character. So far as it proceeds in good faith and by methods prescribed by its laws, its sentence is conclusive like that of any judicial tribunal.

39. A court will, if required, decide whether the grounds for a member's expulsion are well taken.

[1] 1 Vol., § 101, p. 161.

They will interfere in the three following cases: first, when the decision was contrary to natural justice and the member had no opportunity to explain the charge against him; second, when the rules of the club were not observed; third, when its action was malicious and not bona fide.

Action properly taken by an association is final, and the courts will not interfere. Although there may be irregularities in the proceeding, the accused by submitting his case to the tribunal and afterward taking an appeal therefrom acknowledges jurisdiction and cannot afterward sue the association for wrongful expulsion.

40. The charges against a member must be of a serious nature. The following accusations have been held to be insufficient to justify expulsion or suspension: Slander against the society; illegally drawing aid in time of sickness; defrauding the society out of fifty cents; vilifying a member; doing business at less than the established tariff of the society; unprofessional conduct in advertising; disrespectful and contemptuous language to associates; stating that the lodge would not pay and never intended to pay; conviction of actions that may injure the association; ungentlemanly conduct.

It is a sufficient cause for expulsion from a trades union that membership was obtained by feigning a qualification which did not exist, and in remaining after the disqualification was established. Fraud, such as representing himself in good health, when in fact he had an incurable disease, is a ground of

expulsion; and generally it may be said that violations of reasonable by-laws are sufficient to justify the infliction of the penalty prescribed, whether it be suspension or expulsion. The courts, looking at the facts in each case, and construing the by-laws to be reasonable when they are calculated to carry out the just objects of the association, will sustain regular proceedings thereunder [1]

41. A member of a society who is once acquitted cannot be tried again for the same offence.

42. As subordinate lodges of a benefit society are constituent parts of the society, of which the entity and head is an incorporated superior governing body, this fact must be considered in expelling members. There may be an expulsion from membership in a subordinate lodge for violating laws, which generally causes expulsion from the society itself, and there may be a conditional expulsion or suspension. In the first place the lodge may act as an independent body; in the latter as agent of the superior body. Generally, if the assessment is not paid at the fixed time, its non-payment, by the laws of the order, works a suspension, which in fact is an expulsion, although a member may be restored to membership by complying with the laws of the order.

The rights of members of these associations rest in contract and can be taken away only in the manner provided by contract. A member, therefore, cannot be expelled while insane when no notice has been given, nor can an insane member waive anything.

[1] 1 Bacon, § 103, p. 168.

Again, the superior governing body may expel a member, although the by-laws only provide for the expulsion of members of subordinate lodges.

43. An appeal of a member of a subordinate lodge from the vote of expulsion does not abate by the member's death during the pendency of the appeal. If, therefore, on the appeal the judgment of the lodge is reversed, the beneficiary of the member is entitled to receive the benefits agreed to be paid on his death.

44. A member need not appeal from action that is void from want of jurisdiction. It may be likened to a judgment rendered by a court which has no jurisdiction over the subject-matter or the person; it is void. Yet by acquiescence in a wrongful expulsion a member may be considered as waiving his right.

45. As a general rule a member wrongfully expelled from a society may be restored by a mandamus proceeding. The court will examine only so far as to satisfy itself whether the proceedings were in accord with the rules of the society.

Courts are unwilling to sanction a rule that societies doing a life insurance business can expel a member for some infraction of a by-law regulating personal conduct, and thereby causing him to forfeit his insurance. But they will interfere for the purpose of protecting the property rights of members.

46. A distinction therefore is made between cases in which the expulsion is for violating the rules of the society in which no property right is involved, and cases in which expulsion is virtually a forfeiture of property rights. In the latter case a court will satisfy

itself in the way of making an inquiry so far as may be needful to determine the question whether there has been a capricious, arbitrary exercise of power.

47. Unless by agreement between the members of a voluntary association that membership shall be absolute, a member may withdraw at any time. Says the court in one of the cases: "The entering into it, the remaining in it, the performance of duties incumbent upon the member by reason of his membership are purely voluntary," [1] consequently he may withdraw when he pleases without the consent of the association. When doing this, however, he cannot avoid any obligations incurred by him to the association. On the other hand, it cannot after his withdrawal impose any other obligations on him.

48. Notice of withdrawal by a member bars any action for benefits; nor is the association prevented from asserting that a member has voluntarily withdrawn from membership, while denying at the same time his right to take such action.

49. A member of an unincorporated society, who wishes to avoid responsibility for debts by withdrawal, should give notice to the public; but for obligations already incurred he cannot escape liability by withdrawing from membership.

50. It has often been attempted to hold the members of a lodge liable personally for a promised benefit in time of sickness. Says Bacon: "It may be a question of construction in each particular case whether the members are personally liable or not. The better

[1] Ellerbe v. Barney, 119 Mo., 632.

rule seems to be that the members are not held personally liable. In one case the members were held personally liable. In another in which this subject was fully considered the court held that a credit was given to a fund created by the joint contributions of the members who only agreed to pay these stated contributions of dues."

51. The officers of the associations we are here considering are governed by the general principles of agency. The law presumes that each person on becoming a member consents, intends and expects to be represented by needful officers and agents. In the absence of express laws limiting their power, they possess the powers ordinarily possessed by officers and agents, and every member is bound by the rules of the company.

52. An association cannot by its constitution or by-laws confer judicial powers on its officers or committee to adjudge a forfeiture of property rights, or to deprive lodges or members of their property from one set of members and give it to another. This rests on the solid reason that the creation of judicial tribunals is one of the functions of sovereign power; to allow associations to exercise this authority would be contrary to public policy. This is the reason why agreements to refer future controversies to arbitration cannot be enforced; it is a prerogative of the state which cannot be taken away. In a recent case the Supreme Court of Rhode Island remarked: "The finality of such an agreement is objectionable for several reasons. The reason generally given is that

it ousts courts of jurisdiction, and so deprives a party of his rights under the law. While he may waive those rights in a given case, when he knows the circumstances and the effect of his act, it is held to be contrary to public policy for one to bar himself in advance from a resort to the courts for some future controversy of which he can have no knowledge at the time of the original agreement." [1]

53. Unless the by-laws require, a board of directors or agents or a committee are not bound to keep a record or minutes of their proceedings. Says Chancellor Zabriskie: "It is not necessary that the minutes of a corporation should be written up by the secretary in his own handwriting, or that they should be approved by the board."

54. The president is the chief executive officer and his authority or power differs greatly in different companies. Says Bacon: "The power of the president or other chief officer extends only to matters pertaining to the ordinary business. He may perform acts which by usage or necessity are incident to his office without necessary authority. These powers may be inferred from facts and circumstances. If his acts are within the scope of his authority they are binding on the company."

55. The secretary is the officer to keep its records, books and seal, and to act generally under the direction of the directors. His powers are usually prescribed by the by-laws. If they are not he has the powers ordinarily exercised by the corresponding

[1] Pekin v. Société St. Jean Baptiste, 49 St. Rep., 387 (1901).

officer of companies of the same nature. There is no reason why a secretary of an insurance company or benefit society should have powers different from those of a corresponding officer of other organizations. "The secretary is the proper person to have possession of, and prove, the books of the company; and the directors are presumed to have control over him."[1]

56. The treasurer is charged with the custody of its funds and is responsible for their safekeeping. He must keep its moneys distinct from his own, unless otherwise agreed, and pay out balances due on demand. He has no power to bind the company, only in the usual course of business. He cannot sell or assign without special authority the securities of his company.

57. Lastly, a word may be said concerning the trustees of these associations. Their duties and powers are not yet clearly defined. The generally accepted rule is that a voluntary association has no legal capacity to hold real estate; and if it is conveyed to trustees in trust they are simply owners as tenants in common.[2] Consequently, a conveyance of land to trustees of a non-incorporated religious society and their successors in trust for the use and benefit of the society does not vest the title in the new trustees who may be selected from time to time; it remains in the grantees named in the deed, or in their survivor.

In many states the law regulating the trustees of such associations is statutory, and much of the old common law does not apply. The cases are quite

[1] 1 Bacon, § 142, p. 220.
[2] See Vol. I, § 4, p. 232.

frequent, however, in which this question arises. In respect to general contracts, and acts by trustees, the articles of association define, or ought to define their powers; and in most cases the parties look to them for answer to the question.

58. The contributors to a fund placed in the hands of trustees for a specific purpose have a right to compel repayment to them proportionately of any surplus not needed for the object, and also to require the fund to be applied to the objects for which it was raised.

Furthermore, they have a right to recover a contribution to funds still on hand, raised for an object which has failed.

CHAPTER XI

MARRIAGE

§ 1. What Is a Valid Marriage

1. Nature of the marriage contract by common law.
2. There must be an agreement in good faith.
3. Effect of false representations.
4. Whether a fraudulent marriage is void or voidable.
5. What degree of mental capacity is needful.
6. Intoxication.
7. Age.
8. Relationship.
9. Race, colour, religion and social rank.
10. Statutory requirements.
11. Effect of non-observance.
12. Effect of license and solemnisation.
13. Common law marriages are not valid in some states.
14. By the law of what state is their validity determined.
15. Effect of evading the laws.
16. Statute has no effect beyond its jurisdiction except by comity.

1. The law regards marriage as a contract; it is something more. A contract may be terminated by

mutual consent; the marriage relation cannot be. Unlike a contract, the marriage relation is not necessarily terminated, even though one of them becomes incapable of performing his part. In other ways marriage is irreconcilable with our conceptions of an ordinary contract.

After the contracting parties have entered into the marriage state, an eminent legal authority has said that they have not so much entered into a contract as into a new relation, the rights, duties and obligations of which rest, not on their agreement, but on the general law of the state, statutory or common, which defines and prescribes these rights, duties and obligations. They are of law, not of contract. It was by contract that the relation was established; but the relation itself they can neither modify nor change.

2. To constitute a marriage there must be an agreement or mutual assent by the parties. This is essential, and anything showing that there was no agreement is proof that there was no valid marriage. In one of the cases a man and a woman went through the formalities required by law and were pronounced man and wife by a person who was authorised to perform the marriage ceremony. As the parties did this merely as a joke, the marriage was held to be invalid.

3. False representations of rank, fortune, health, etc., do not render a marriage invalid. There may be misstatements of such a serious character as to form just ground for annulling a marriage. When consent is obtained by deceit, so gross that the nature of the marriage is not understood, it may be avoided. Such

cases arise when one of the parties takes advantage of the extreme youth of the other. A marriage under duress or compulsion is lacking the consent required by law. The legal rule is, if either party be in a state of mental incompetency to resist pressure, which is used, there is no legal consent and therefore the marriage is void.

4. A marriage caused by fraud or duress is sometimes said to be void, and sometimes voidable. The better opinion is that it is voidable at the option of the person deceived, coerced or mistaken.

5. When, by reason of mental defect, a person has not sufficient capacity to give an intelligent consent, he cannot enter into a valid marriage. What mental imperfection will invalidate a marriage is still an open question. The general rule is that the parties must be able to understand marriage and its consequences.

The insanity or other mental weakness must exist at the time of the marriage, a subsequent weakening or overthrow of the mind would not be sufficient. As an Illinois court has recently said, it would be a harsh rule that would permit a married man whose wife later in life becomes insane to put her away on account of her inexpressibly sad misfortune.

Some of the authorities maintain that insanity renders a marriage voidable and not void when the person on regaining his reason, even temporarily, affirms the marriage. And some authorities also maintain that had the other party known he was marrying an insane person he cannot avoid the marriage.

6. Intoxication at the time of one's marriage avoids it for the same reason as insanity, because there is no real consent. But the intoxication must be so excessive as to prevent intelligent action.

7. The age at which a minor can make a marriage contract by the common law is fourteen for males; twelve for females. By statute the age has been fixed at a later date for both sexes, usually twenty-one for males and eighteen for females. Marriages made by minors who are above the age to consent are binding on them and cannot be avoided after they attain their majority. The reason why marriages made above the age of consent yet during minority cannot be avoided on attaining majority is that it is not a contract, but a status involving important rights and interests to property and children which public policy will not permit to be jeopardised at the will of either party.

A minor's promise to marry, though he is over the age of consent, may be avoided by him like any other contract because none of the complications above mentioned arise if it is not executed.

Sometimes the courts hold that a marriage by a minor under the age of consent is void until affirmed. The Supreme Court of Ohio has declared concerning marriages in that state, contracted by male persons under the age of eighteen and female persons under fourteen, that they are invalid unless they live together after arriving at these ages respectively.

The right to disaffirm a marriage on the ground of non-age is not limited to the party who is under the age of consent, if the other party was of suitable age,

but extends to the latter. In this respect marriage differs from a contract. A person under the age of consent is not estopped or prevented from avoiding his marriage on reaching the age of consent by the fact that he fraudulently misrepresented his age.

8. Relationship is another incapacity to marriage. Formerly, the disqualifications of relationship were regulated or determined by the Church; and the rules that have been adopted by the Legislature of every state in the Union follow closely the law enacted in England during the reign of Henry VIII. We have given in a note the relationships that are generally regarded as contrary to law in entering into the marriage contract.[1] This follows closely the law of the Old Testament, and it may be added that the penalties for violating them have been increased of late years in many states.

The question causing greater discussion during recent years, both in the English Parliament and in other places, has been the right of a man to marry his former

[1] Archbishop Parker's table of degrees has been, since 1563, the standard adopted in the English ecclesiastical courts. (Schouler's Domestic Relations, § 16.) The statute prohibition includes legitimate as well as illegitimate children, and half-blood kindred equally with those of the whole blood. Its principles have been recognised in the United States.

A man may not marry his:	A woman may not marry her:
1. Grandmother.	1. Grandfather.
2. Grandfather's wife.	2. Grandmother's husband.
3. Wife's grandmother.	3. Husband's grandfather.
4. Father's sister.	4. Father's brother.
5. Mother's sister.	5. Mother's brother.
6. Father's brother's wife.	6. Father's sister's husband.
7. Mother's brother's wife.	7. Mother's sister's husband.
8. Wife's father's sister.	8. Husband's father's brother.
9. Wife's mother's sister.	9. Husband's mother's brother.
10. Mother.	10. Father.
11. Stepmother.	11. Stepfather.
12. Wife's mother.	12. Husband's father.
13. Daughter.	13. Son.
14. Wife's daughter.	14. Husband's son.

wife's sister. The relationship is one of affinity, as no blood relationship exists between the two. The English law up to a recent date declared this to be a positive impediment. In most of the American states such a marriage has the sanction of law. The courts have declared the marriage to be proper in some states, where no statute on this subject exists.

9. By common law, and also by the law of England, no impediment to marriage exists on account of race, colour, religion or social rank. In many of the United States by statute there are some restrictions between the marriage of white persons with Indians, Negroes, Chinese, and the like. These statutes declare the marriage to be absolutely void, without the necessity of a judicial decree.

10. The contract of marriage by common law legally requires nothing more than the full, free, and mutual consent between the parties who are capable of contracting; but by statute in many states every marriage must be celebrated in some manner and a proper record made of it. Before establishing these regulations, in some of the states grave difficulties arose concerning the division of property, turning on the question whether the person who had left the estate was really married or not. The Council of Trent declared null and void every marriage not celebrated by a priest or by license of an ordinary, and before two or three witnesses. These regulations were not promulgated by Philip II., in his European Dominions, and consequently were not extended to the Spanish Colonies in this country. Therefore, in them, to constitute

a valid marriage, nothing more was necessary than the consent of the parties.

In this country marriage is regulated by the states; the National Government has no legislative control over the subject. A state legislature has full power to prescribe reasonable regulations on the subject, and to impose penalties on those who contract marriage contrary to statutory requirements without rendering the marriage void. Even marriages prohibited by law are not absolutely void unless they are so declared, because the law, for reasons of public policy, regard such contracts as of a higher character than others relating to property and ordinary dealings among men.

11. A marriage is not void simply because the formalities prescribed by statute in obtaining the license and solemnising the marriage have not been observed. It is, we believe, the law everywhere that a marriage without a license and solemnisation is valid if the parties consent thereto and afterward live together like other married people. A marriage ceremony, therefore, performed by an official outside his jurisdiction, is not for that reason void. For the same reason a marriage is not void because the license was obtained from an improper court or person.

12. The license and solemnisation are regarded merely as directory acts, consequently their improper fulfillment does not invalidate a marriage. Ministers and magistrates who grant licenses and solemnise marriages may suffer legally for not properly executing the laws, but their failure does not affect the parties to the contract or the marriage relation. The principle

is generally sustained that a marriage, good by the common law, is valid notwithstanding the neglect of statutory forms relating to the subject, unless the statute itself contains express words declaring the act to be only a pretended marriage and not a real one.

13. In some states common law marriages are not valid; this is a departure from the general doctrine. Such is the law in the state of West Virginia; no marriage contracted is valid unless it has been solemnised in the manner prescribed by statute. Likewise in Kentucky marriages not solemnised in the presence of an authorised person or society are void.

14. The validity of a marriage is governed by the law of the place where it was made. A marriage that is valid in the state where the ceremony was performed will be recognised in every other; thus, a second marriage in Mississippi is binding in Louisiana, although the first marriage was void by the law of Mississippi, the husband having at that time a wife living and from whom, before the second marriage, he had been divorced.

15. State courts will recognise as valid all marriages made in a foreign country, the forms and usages of which have been regarded. A marriage between a Chinaman while in this country and his betrothed in China cannot be regarded as a valid Chinese marriage. A marriage on the ocean must be determined by the law of the state where the parties lived.

The opposite rule, therefore, is equally true that a marriage void in a state or place where it was celebrated is void everywhere.

There are some exceptions to this rule, the most important of which is a marriage by the parties outside the state in which they live for the purpose of evading their own law. This cannot be done, though the courts are very slow in applying the principle. They seek to maintain marriages whenever this can be done with a due regard to the rights and interests of all concerned. This course or practice is best calculated to protect the welfare of the country in the preservation and happiness of the most important domestic relation in life.

The statute of Massachusetts declares that when residents of that state, for the purpose of evading its marriage laws, go into another state and have the marriage solemnised and afterward return thereto the marriage is void. Such is the law also in many other states, but the rigour of the statute is much lessened by holding that *both* parties must have intended to evade the law, otherwise the courts will not declare the marriage to be void.

In other states a marriage by the guilty party in a divorce suit who is prohibited from remarrying within a specified time, is void, especially if the offence is a felony. Again, when the guilty divorced party is prevented from marrying without leave of the court, which is violated, the subsequent marriage is invalid, although the party thought he had a right to marry.

In some states a guilty defendant is prohibited from marrying during the lifetime of his spouse, and a clause to that effect is usually inserted in the decree. A marriage, therefore, in violation of this prohibition

is void. On the other hand, in other states the marriage of such a person within the time prohibited by statute is not absolutely void unless the statute says so, but is merely voidable. In other words, it is valid until set aside by proper judicial action.

16. The statute of a state prohibiting a guilty party in a divorce suit from marrying has no force beyond the state in which the divorce was granted; it cannot therefore prevent him from lawfully marrying in another state, although by so doing he may be subject to punishment in the former state should he ever come within its jurisdiction. Though the laws of every state concerning marriage and divorce, as well as those relating to crimes and all other matters, of course have no force or power outside the enacting state, effect is often given to them elsewhere, by virtue of the great principle of state comity, and not by virtue of any inherent power in the laws themselves.

§ 2. The Husband's Guardianship

1. He is his wife's protector.
2. How far he can restrain her.
3. Correction.
4. His domicile becomes hers.
5. Her personal liability for wrongs.
6. Acts that would be wrongs if done to others are not wrongs if done to each other.
7. When husband is responsible for her wrongs.

8. He is not liable for her wrongs relating to her separate property.
9. Husband's right of action for alienating his wife's affections.
10. Wife's right of action for same cause.

1. After marriage questions arise concerning the conduct and property of the respective parties. The law places the wife under the guardianship of her husband, from whom she is entitled to protection from the dangers of the world. He, therefore, has a right to exercise all the protection needful to fulfil the laws and customs of society.

2. How far he can go in the way of exercising restraint over her is still, notwithstanding all the decisions, a somewhat shadowy rule or doctrine. In this country, says an authority, the right has been exercised so far as to allow a husband to restrain his wife from committing a crime, or interfering with the parental exercise of authority over his children. A man, it is said by the Supreme Court of Pennsylvania, has a right to a reasonable control over his wife's actions.

3. Blackstone declared that a husband had a right to give his wife moderate correction. No such right is recognised to-day. Chastisement is unlawful in any case and will render a husband guilty of assault and battery. Furthermore, if severe or often repeated, by the laws of many states this is a good ground of divorce for cruelty. An eminent jurist of New York (Chancellor Walworth) remarked a long time ago that whatever

may be the common law on the subject, the moral sense of this community in our present state of civilisation will not permit the husband to inflict chastisement on his wife even for the grossest outrage.

4. The general rule is that after marriage the husband's domicile becomes that of the wife; in other words, he has the power to establish the family domicile, and it is her duty to follow him; furthermore, her refusal to follow, without sufficient excuse, is in law, desertion.

A promise before marriage not to take her away from her mother and friends is not binding, and does not justify her refusal to go with him to his new home.

Of course, a wife who has already begun a suit for a divorce in her own domicile immediately after marriage may pursue her remedy in the state where she has always lived.

5. A married woman is answerable personally for her crimes as if she were unmarried. But when she commits an offense in her husband's presence she is presumed to have acted under his coercion, and he must suffer while she escapes. This rule does not apply to the gravest crimes. Should both act in murdering another both would be equally guilty.

The presumption of her guilt does not exist unless she was so near to him as to be under his coercion or control; consequently, if in his absence she does a criminal act, even by his order, her marriage will be no defense. This rule was applied to a woman who was indicted for unlawfully selling intoxicating liquors. It

appeared that at the time of making the sale her husband was not in the room with her, but on the premises. In all cases the presumption of coercion is not conclusive, even when the wife acts in the immediate presence of her husband. It may be repudiated by showing that she acted of her own free will in doing the unlawful deed.

Lastly, it may be remarked that, in some states, this rule of a husband's liability for the wife's crime has been changed by statute.

6. It is a legal principle of universal recognition that husband and wife are one person; consequently many of their acts, which if perpetrated on strangers would be crimes are not crimes because the perpetrators are related by the law in such a unique manner. For example, a husband or wife cannot steal from the other, or, to use a legal phrase, cannot commit larceny. On one occasion an attempt was made to sustain an action by a wife against her husband, after a divorce, for an assault committed upon her during marriage. It was contended by her counsel that marriage or coverture merely denied the right of action and did not destroy it, but the court declared that the error in this proposition was the supposition that the cause of action or right of action ever existed. In such a case there is neither remedy nor right to be redressed.

Nor can a woman either before or after divorce maintain an action against persons who assisted her husband to commit a wrong against her, like assault and battery, during marriage.

In a few states, however, the common law rule has been changed by statute so that a wife can maintain an action against her husband for a wrong. And some statutes, giving a married woman power to acquire and dispose of her property without the control of her husband, have been construed as giving her a right of action for any injury done by her husband to her separate property. But on more than one occasion the courts have construed these statutes differently.

To this rule, that both man and wife are one person, there are some exceptions. If either kills the other the killer is liable for the homicide. In like manner either of them is criminally liable for an assault or battery on the other.

7. By the common law a husband was liable for the torts or wrongs committed by his wife either before or during marriage. This liability was ended by the death of either party, or by a divorce. By the modern law this rule has been greatly changed, and very few traces remain in the various states of the Union. Now, he is not liable for the wrongs committed by her unless he has participated in them. The statutes in the various states differ greatly in detail, but their general features are similar. For instance, he is not liable for slanderous words spoken by her in his absence. In some states the statutes removing the disability of a married woman to sue and to be sued, and taking from the husband his common law rights to her property and earnings, impliedly removes his common law liability for the wrongs she may commit when he is not present.

In New York and several other states a husband is still liable for slanderous words spoken by his wife in his absence, and also for an assault and battery or other personal wrong.

8. In the latter states there is a limitation that must be mentioned. His ability does not extend to wrongs committed by his wife in the management and control of her separate property. For example, should she commit a fraud in selling it, or be guilty of any other wrongful act concerning it, he would not be liable.

Another curious result flows from this provision of law. A wife who is capable by statute of managing and controlling her separate estate may in turn be liable for the wrongs of her husband while he is acting as her agent under authority from her. Of course, he is solely liable for the wrongs committed by himself alone in relation to his wife's separate property. If he participates with her in the commission of any wrong both are liable.

9. A husband has a right of action for damages against anyone who alienates the affections of his wife or deprives him of her society and services by enticing her to leave him, or by harbouring her. This right of action is not defeated by showing that he and his wife did not live happily together, but should her comfort and society be of less account to him by reason of their unhappy relations, these facts may be shown to lessen the damages.

In such cases the existence of malice or an improper motive is always a material consideration.